

3-1992

Implications of GATT for Eastern Europe and the Baltics

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Implications of GATT for Eastern Europe and the Baltics

Abstract

The story of agriculture in Eastern Europe during the last quarter century is a story of policy driven by politics, rather than by sound economics. Even in the highly distorted economics of the socialist period, agricultural policy stands out as being singularly colored by ideological imperatives, and singularly vulnerable to interest group pressures. While the revolutions of 1989-91 did mark a sharp move towards liberalization, these moves are now being slowed and even reversed, as countries of the region adopt Western style interventionism on preparation for accession to the European Union.

Keywords

Agriculture, Policy, Regional economics

Disciplines

Agricultural and Resource Economics | Agriculture | Economic Policy | Regional Economics

**Implications of GATT
for Eastern Europe and the Baltics**

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GATT Research Paper 93-GATT 7

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This material is based upon work supported by the Cooperative State Research Service, U.S. Department of Agriculture, under Agreement No. 92-38812-7261. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the authors and do not necessarily reflect the view of the U.S. Department of Agriculture.

Rachael Goodhue acknowledges the support of a National Science Foundation Graduate Research Fellowship. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the authors and do not necessarily reflect the view of the National Science Foundation.

The authors would also like to thank the following individuals for their assistance: Herve' Ossard, who provided feedback on a manuscript; from Bob Lyons, Leo Simon, Klaas van 't Veld, and Gary Casterline, who offered freely their invaluable help in navigating LATEX; and from the endlessly competent reference librarians at the Giannini Foundation and the UC Berkeley Government Documents libraries. Above all, we would like to acknowledge the inspiration and guidance of Gordon Rausser, without whose steady encouragement this document would not have been. The responsibility for any remaining errors or omissions stays, of course, with the authors.

ABSTRACT. The story of agriculture in Eastern Europe during the last quarter century is a story of policy driven by politics, rather than by sound economics. Even in the highly distorted economies of the socialist period, agricultural policy stands out as being singularly colored by ideological imperatives, and singularly vulnerable to interest group pressures. While the revolutions of 1989–91 did mark a sharp move toward liberalization, these moves are now being slowed and even reversed, as countries of the region adopt Western style interventionism in preparation for accession to the European Union.

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1. INTRODUCTION

Our goal for this paper is to provide, in compact form, a broad overview of the agricultural policies and performance of the Central and Eastern European and Baltic region from 1970 to the present, a region currently comprising the nine independent nations of Hungary, Poland, the Czech and Slovak Republics, Bulgaria, Romania, Lithuania, Latvia, and Estonia. We focus on the impact of regional and global trade agreements, including particularly the Uruguay Round of the General Agreement on Tariffs and Trade, and the various agreements that increasingly bind the region to the countries of the European Union. We also review briefly some of the academic literature in the field.

Our discussion is informed by three themes that we feel are central to an understanding of how the region's agriculture has been organized in the past, and of the policy environment in which it will operate in the near future.

- (1) *The overriding importance of extra-economic political factors in the formation of economic policy.* Political factors are an important consideration when assessing the potential trading performance of the CEE and Baltic countries. These states are seeking to define their place in the new world order both economically and politically. This paper examines a part of this process, focusing on agricultural trade.
- (2) *The "singular status" of agriculture.* In all countries of the region, under both socialism and market regimes, agricultural policy has been designed with a vision of farming and food-related industries as being sharply distinct from other forms of enterprise. Consistently, agriculture is given tasks to which it is not well-suited, or a policy environment that stifles productivity. Some of the differences in policy are justified by economic principles; others by political ideology, by history, by interest-group pressure, and, recently, by a conscious (if ill-studied) mimicry of the West. While the revolutions of 1989–1990 opened the door on the possibility to rationalize agricultural policies, this door appears to be quickly closing, as a new interventionism waxes ascendent throughout the region.
- (3) *The emergence of the drive for EU accession as the central force in current policy design.* Since the collapse of the socialized systems for production and trade, the region's trade has been sharply reoriented to the West.¹ Indeed, all countries of the region aspire to EU

¹ We pay no explicit attention to military issues; we do not discuss NATO, CSCE, or other security arrangements. Nonetheless, our story would be incomplete without at least mentioning that the westward reorientation of trade parallels and is largely

membership, and are, to varying degrees, willing to reform their institutional structures and sacrifice other policy goals in their drive to make their accession as rapid as possible.

We begin with a historical perspective. Section 2 presents the history of the agricultural economies of the region during the socialist period, and reviews how the political changes in 1989–91 have expressed themselves in dramatic changes in patterns of production and consumption, and in an equally dramatic reorientation of the region's trade toward the world's wealthier industrialized countries. We also review a number of studies that suggest that this reorientation is not a phenomenon of the transition, but a fundamental and lasting shift. (Appendix A provides a reference of trade policies currently in force, country by country.)

Section 3 surveys the emerging opportunities for trade brought about by newly forming regional trade agreements, and, more importantly, by the various agreements reached with the European Union (EU) and the European Free Trade Association (EFTA).

In section 4 we study the impact that the recently completed Uruguay Round is likely to have on the region's agricultural trade. We examine the technical reasons why the reformed GATT will tend to provide a boost to the region's agricultural trade, imposing few immediately binding constraints while opening important new markets for exports, and potentially enhancing chances for accession to the EU.

Section 5 surveys the interdependent domestic policies of each country. We summarize briefly the several responses of the region's countries to the difficult structural challenges they face as they attempt to privatize ownership of agricultural land and farm-related enterprises and to inject competition into their agricultural economies. We find that while many important initiatives have been launched "on paper," it appears to be too early to call any of the restructuring efforts a success. (Details of these policies are summarized systematically in appendix B.) Section 6 concludes our overview with an analysis of the political constraints that will continue to shape the region's agricultural policies.

abetted by a concurrent security realignment.

2. HISTORICAL PATTERNS OF PRODUCTION, CONSUMPTION AND TRADE

Agriculture was the Achilles heel of the Soviet model as implemented in Eastern Europe and the former Soviet Union. In this section of our paper we seek to give a brief overview of pre-reform policies, and of those undertaken since 1989 that impact the current situations of these countries. This section is supplemented by a description of each country's trade policies in the appendix and by relevant tables, also in the appendix. For the Baltics, relatively less attention is focused on the pre-reform period, due to their inclusion in the Soviet Union, while relatively more attention is paid to the pre-reform policies in CEE countries which were never fully integrated into the Soviet Union.

2.1. The Baltics.

2.1.1. *Effects of the Soviet Period.* Prior to World War II, the Baltics' industrial sector was relatively small, accounting for no more than 18 percent of employment. Major industrial sectors at that time included food processing, light industries (particularly textiles), and woodworking. In the 1950s the Baltics began rapidly to industrialize, based on decisions by the central Soviet authorities. The Soviet occupation also brought about decisive structural changes in the Baltics' agricultural sector. Larger farms were nationalized and a system of obligatory procurement, according to which all farms had to deliver a large portion of their output to the state, was introduced. By the 1950s, after massive deportations and forced collectivizations, the vast majority of rural population lived and worked on collective farms. Although some were allowed to keep their plots, most individual rights to land and other productive assets were curtailed. Markets for all agricultural inputs and outputs were suppressed and various agencies for storage, processing, transport, marketing and trading centrally commanded. The Soviet emphasis on industry meant that agriculture was neglected. In fact, productivity in the sector lagged and, in spite of its agricultural resource endowment, the Soviet Union was often a net food importer (Pajo, Tamm and Teinberg, 1994; World Bank, 1993a; World Bank, 1993b; World Bank, 1993c).

2.1.2. *Recent Economic Performance.* At present, industry, particularly heavy industry, is the Baltics' largest economic sector, accounting in 1990 for nearly one-third of employment. For instance, in Lithuania machine building is the largest industrial sector, accounting in 1990 for 27 percent of industrial output and 38 percent of industrial employment. In Latvia, engineering and

chemicals accounted for more than 33 percent of industrial output and more than 44 percent of industrial employment; in Estonia, each accounts for about one-quarter of industrial output (World Bank, 1993a; World Bank, 1993b; World Bank, 1993c).

In the last two years, the Baltics' industrial enterprises have been affected by various external developments. In April, 1990, following Lithuania's declaration of independence, the Soviet Union imposed a blockade on supplies of crude oil and natural gas to Lithuania. Although it was lifted shortly thereafter, the subsequent gradual disintegration of the Soviet political and economic structure resulted in a curtailment of supplies of raw materials and energy to Lithuanian enterprises. Although the Lithuanian government has made strenuous efforts to negotiate trade agreements with several of the former Soviet republics (see Section 3.2), supplies of critical inputs, including in particular energy, have often remained in shortage. Although these agreements provide that Lithuania will be supplied have often not reached the agreed quantities. In 1991, for example, supplies of crude oil and coal were about 70% of the quantities agreed. According to Lithuanian Ministry of Economics, 85% of the enterprises in the machine building and chemical industries have experienced severe shortages of inputs. Other subsectors faced similar difficulties. Furthermore, due to the reduction in defense expenditures in other former Soviet republics, the demand for some Lithuanian electronic products has been sharply reduced. A general decline in investment in the region has led to reduced demand for equipment produced in Lithuania. The demand for Lithuanian-made computers has also declined, as higher quality Western computers have rapidly increased their market shares.

Partly due to these external shocks, total industrial output in Lithuania increased by only 0.3% in 1990, and declined by 1.3% in 1991. The sharpest declines in 1991 were an 8.5% drop in food processing, due mainly to a shortages of imported grains, and a 55.6% fall in building materials. Overall, the output of 366 industrial enterprises accounting for 60% of all enterprises declined in 1991 (World Bank, 1993c).

For similar reasons, in Latvia the output of industrial enterprises declined by less than 1% in 1991. This seeming stability in output masks differences in the performance of the state and private sectors; the output of state owned enterprises declined by 5 percent, whereas privately owned and joint ventures increased output by 34 percent. This situation deteriorated substantially in 1992 when industrial output declined by 34 percent in the third quarter, as compared to a year before. This dramatic change resulted in large part from a terms-of-trade deterioration (World Bank,

TABLE 1. Lithuania: Production, 1990-1991 (thousand metric tons)

Commodity/thousand tons	1990	1991	percentage change 1990-91
Grain	3265.1	3347.5	2.5
Sugar Beet	912.4	811.2	-11.1
Potatos	10.1	13.1	29.7
Vegetables	295	398.4	35
Milk	3157	2915.6	-7.6
Eggs/million units	1272.6	1234.7	-3
Wool/metric tons	141	128	-9.3
Meat	530.1	449.6	-15.2

TABLE 2. Lithuania: Percentage output change, 1990-1992

Sector	Output change from 1990 to 1991	Jan-Sep 1991	Jan-Sep 1992
Food Industry	-8.5	-44.1	
Light Industry	6.5	-26.8	
Machine Building and Metallurgy	6.5	-48.5	
Forest Industry	0.9	-50.4	
Chemicals	0.5	-53.8	
Building Materials	-5.6	-41.7	
Total Industrial Sector	-1.3	-47.3	

1993b). In Estonia, the decline in industrial output was particularly sharp, dropping by as much as 50 percent in 1991, since Estonian enterprises relied heavily on raw materials from the former Soviet Union. Specifically, Soviet energy, metals, chemicals and machinery accounted for more than half the inputs in Estonian industry (World Bank, 1993a).

At present, agriculture is an important sector in the Baltic economies, accounting on average for about a quarter of GDP and 15 percent of the labor force (respectively, 24 and 18 percent in Lithuania, 20 and 16 percent in Latvia and 22 and 12 percent in Estonia). It consists of 7.4 million hectares of agricultural land (3.5m in Lithuania, 2.6m in Latvia and 1.3m in Estonia) of which nearly 5 million is arable (2.3m in Lithuania, 1.7m in Latvia and 1m in Estonia). Of the arable land, nearly half is used for forage crops (41 percent in Lithuania, 50 percent in Latvia and Estonia), with the balance under cultivation in grains (48 percent in Lithuania, 42 percent in Latvia and 43 percent in Estonia), potatoes (5 percent in each), and flax and sugar beet (3 percent in Lithuania, 2 percent in Latvia). Overall, crops account for less than one third of the aggregate value of agricultural production (34 percent in Lithuania, 29 percent in Latvia and 26 percent in Estonia). Within the livestock subsector, the largest additions to aggregate value came, in 1990, from dairy cattle production (44 percent in Lithuania, 38 percent in Latvia and 29 percent in Estonia), followed by hogs (15 percent in Lithuania, 20 in Latvia and 18 percent in Estonia), meat

cattle (26 percent in Latvia and 17 percent in Estonia) and poultry (6 percent in Lithuania and Latvia and 7 percent in Estonia) (World Bank, 1993a; World Bank, 1993b; World Bank, 1993c).

In 1991, the number of animals on state and collective farms declined significantly, with the largest declines for hogs and poultry and the smallest for cattle. These declines resulted from the shortfalls in imported feed supplies, as well as from the disruption and uncertainties associated with privatization and reorganization. These disruptions include a substantial loss of skilled managers and technicians from the collective and state farms who found more promising opportunities elsewhere. As a consequence of the decline in livestock numbers, meat production fell, in 1991, by as much as 29 percent in Estonia, 15 percent in Lithuania and 6 percent in Latvia. Milk and eggs production fell by, respectively, 16 and 26 percent in Estonia, 8 and 5 percent in Lithuania, and 7 and 6.6 percent in Latvia (World Bank, 1993a; World Bank, 1993b; World Bank, 1993c). Similarly, the per capita consumption of all major agricultural commodities declined drastically.

TABLE 3. Estonia: Per capita consumption of selected foods, selected years (kilograms)

Year	Meat	Fish	Milk	Eggs	Sugar	Vegetable oil	Potatoes	Cereal	Vegetables	Fruits
1970	73	29.5	420	24	43.6	6.7	151	112	80	
1980	82	24.9	453	305	46.0	9.0	122	96	83	38
1985	89	24.6	489	296	44.7	9.5	113	92	79	44
1986	89	25.5	484	304	46.1	9.6	126	93	94	
1987	87	26.3	481		49.5	9.6	123	93	87	
1988	82	25.3	478	294	49.5	7.8	109	87	82	43
1989	84	23.6	508	308	43.6	8.3	100	80	79	43
1990	84	24.0	487	289	44.5	7.0	103	77	64	36
1991	63	21.0	409	260	36.1	6.3	104	79	57	27

TABLE 4. Latvia: Per capita consumption of selected foods, selected years (kilograms)

Year	Meat	Fish	Milk	Eggs	Sugar	Vegetable oil	Potatoes	Cereal	Vegetables	Fruits
1970	70	21.5	453	194	46.3	6.7	146	110	82	
1980	76	23.4	403	259	46.3	8.8	128	107	72	43
1985	85	23.8	455	295	46.8	8.8	122	104	80	52
1986	84	23.6	465	304	49.3	8.6	127	105	82	62
1987	84	23.6	471	300	51.3	8.5	125	104	81	54
1988	85	22.8	455	294	50.8	8.0	117	107	76	38
1989	85	23.6	457	286	46.9	8.8	120	102	76	42
1990	83	22.5	454	259	48.1	7.8	125	107	69	33
1991	75	18.0	427	240	40.5	3.8	127	112	74	40

2.1.3. *International Trade.* Information on the Baltics' international trade is incomplete and difficult to evaluate, since existing trade statistics are often incomplete, based on distorted domestic

TABLE 5. Lithuania: Per capita consumption of selected foods, selected years (kilograms)

Year	Meat	Fish	Milk	Eggs	Sugar	Vegetable oil	Potatoes	Cereal	Vegetables	Fruits
1970	72	14.9	464	208	37.3	3.7	212	113	86	
1980	81	16.7	415	253	41.2	6.3	150	111	78	47
1985	87	17.8	409	285	43.5	7.8	134	107	84	52
1986	84	19.4	431	305	43.7	8.2	138	110	85	69
1987	85	20.0	438	317	47.3	8.6	139	110	84	58
1988	87	19.4	441	319	50.0	7.4	143	111	84	49
1989	84	18.7	454	320	47.0	8.3	154	109	87	60
1990	89	18.6	476	304	43.2	7.3	146	108	79	33
1991	79	10.5	352	275	28.7	3.6	155	92	92	46

prices, and obscured by artificial ruble exchange rates. In addition to these data problems, in 1990 and 1991 the Baltics' trade was affected by a number of exceptional events and developments, such as the temporary trade blockade by the former Soviet Union, the different pace of price reforms in the Baltics and other former republics, and last but not the least, the dissolution of Soviet trade arrangements. More importantly, ongoing structural reforms in the Baltics' and in the other former Soviet republics are likely to further alter the structure of the Baltics' trade with the former Soviet Union.² For these reasons any quantitative analysis of the Baltics' international trade is subject to a large margin of error and should be interpreted with great caution. However, a close look at existing trade statistics provides some interesting insights.

As a result of its past integration with the Soviet economy, the Baltics' international trade has been strongly oriented toward the former Soviet Union, in recent years. Official statistics show that Soviet trade accounted for about 90 percent of the Baltics' total external trade. The remaining part was largely conducted with the former CMEA countries (other than the former Soviet Union) and a limited volume of trade in convertible currency (World Bank, 1993a; World Bank, 1993b; World Bank, 1993c). This particular composition of trade reflects the Baltics' structure of production, which is oriented towards machine building and metal industries (with a large share of consumer electronics), light industry (primarily textiles) and food production (with a large share of animal husbandry). It also indicates the Baltics' strong dependence on inputs from other former Soviet republics. For instance, Lithuania is a large importer of oil and gas from Russia, which it uses to produce and export electricity and also to re-export. Similarly, Lithuania imports cotton, wool and other fibers from the Central Asian republics, primarily Uzbekistan and Kirghizia, for its textile industry, which accounts for more than 20 percent of its exports (World Bank, 1993c).

² For instance, the withdrawal of Soviet troops will be associated with a significant reduction of Soviet imports primarily used by the military, especially metals, metalworks and machinery.

In 1991, the gradual breakdown of the centralized trade regime made trade with the former Soviet Union increasingly difficult. Both the volumes of Baltics' exports and imports fell significantly. These events led to domestic shortages of a growing number of critical inputs and consumer products. A lack of imported inputs also contributed to a reduction in non-former Soviet Union exports, and a severe shortage of hard currency led to a sharp fall of convertible currency imports (World Bank, 1993a; World Bank, 1993b; World Bank, 1993c).

2.2. Central and Eastern Europe. Although these countries were not fully absorbed into the former Soviet Union as the Baltic states were, they were strongly influenced by the USSR after World War II, and followed the Soviet model of development, which heavily emphasized industry at the expense of agriculture and production at the expense of consumption. In practice, the Soviet model resulted largely in extensive growth, where more and more inputs were required to continue growth in production. The continued post-war existence of these countries as independent states facilitates a more thorough examination of their historical policies than for the Baltics.

2.2.1. *The Seventies: Import-led Growth.* The seventies were a period of rapid growth in CEE countries. This was largely due to the pursuit of an import-led strategy of economic growth, followed most notably by Poland and Romania. These countries hoped that by infusing Western technology, they could improve their production processes and thereby move to a more intensive growth strategy. Rather than financing this strategy through cuts in domestic consumption, money was borrowed abroad and used to purchase capital equipment and inputs. The final goods produced using these purchases were to be exported abroad for hard currency, which would be used to repay the original loans and fund further growth.

During this period, total production did increase. According to some observers, product quality did as well. Unfortunately, in many cases product quality did not improve enough to allow unambiguous success in exporting to Western markets.³ During the decade, the exports of mineral fuels, chemicals and manufactures grew as shares of total CEE exports to the West (Ellis, 1986). This trend may have been due to poor performances in other sectors, such as agriculture, rather than to significant improvements in the refining, chemical and manufacturing sectors. Trade with LDC countries increased in importance for CEE countries in the seventies, although not substantially;

³ This verdict is confirmed in the case of Czechoslovakia by the Czech government itself; products they classified as being at 'world technical and economic level' fell from five to two percent of total production between 1970 and 1980 (Levcik, 1986).

on a percentage basis, trade with LDCs rose from 8 to 11 percent of CEE exports, while imports from LDCs stayed at about 6-8 percent of total imports (Ellis, 1986).

One reason for the adoption of an import-driven growth strategy in the seventies was increased consumer discontent. This dissatisfaction peaked in Poland, where an announced food price increase in 1970 led to riots and a change in leadership. The increased foreign borrowing aided regimes in subsidizing consumption in order to buy political popularity. In Poland, the growth rate of national income allocated for consumption was 8.7 percent annually from 1971-1975. Since the growth rate of national income allocated for investment was 18.1 percent while the growth of national income was only 9.8 percent, it is apparent that foreign borrowing was key to Poland during this period (Vanous, 1985). Consumption and investment exceeded production for the other CEE countries as well.⁴

Agriculture did not excel in CEE countries, in part due to the tendency under the Soviet model to favor industry. However, agriculture did share to some degree in the boom of the early seventies. In all countries except Czechoslovakia, agricultural output expanded at a faster rate between 1970-1975 than from 1965-1970.

The drive for food self-sufficiency and autarky, itself a part of the Soviet model, along with consumer demands meant that governments had to address problems in this sector. (Waedekin, 1985) argues that the regimes' concentration on industry and the corresponding demographic changes due to rapid industrialization worsened their problems with agriculture; not only did the governments neglect improving agricultural productivity and increasing production, but the growing class of wage earners demanded more and better food, so that even when production increases were realized they were inadequate to meet the changes in demand.

One common feature was the emphasis on increasing meat production in order to satisfy consumers and help demonstrate to them the superiority of the Soviet system by raising their food consumption. In all countries excluding Hungary, the growth of production of animal products was higher than the growth of production of crop products in the 1970-1975 period; from 1975-1980, this was true in all CEE countries without exception (Lazarcik, 1985). Some countries even used hard currency to import grain in order to produce more meat.

⁴ Excluding Romania, for which this information was not available.

In the early part of the decade, the CEE countries were aided in their pursuit of import-led growth by international market conditions. The massive amount of available petro-dollars meant that bankers were eager to make loans and were less likely to closely examine requests. The second oil crisis and the soaring interest rates of the late seventies adversely affected the CEE countries; the rising interest rates made it harder for them to repay their debts, and the Soviet Union raised the price it charged them for oil, which affected their ruble trade. Their terms of trade with the West worsened. Romania and Poland were the most affected by the debt crisis, and plunged their citizens into austerity drives. Growth slowed in the other countries as well; not only did they need to cut consumption in order to finance their existing debts and to pay for the increased price of Soviet oil, but they were largely unable to obtain foreign loans to finance the continued import of inputs after Poland defaulted on its debts. The aftereffects of import-led growth continued into the eighties. While no one country can be considered a perfectly representative case, the general pattern, if not intensity, of responses is shown by the case of Romania.

In response to the debt crisis, Romania reduced trade levels and increased hard currency surpluses from trade. Real net exports increased, even as the country suffered a large decline in its terms of trade. The GDP growth rate fell in the eighties, compared to the seventies. Domestic use of GDP fell in the early eighties, with a large decrease in investment. For consumers, statistics do not reflect a large decrease in production, but one analyst postulates that this is due to the inclusion of in-kind income produced by rural residents, and that urban residents suffered a decline in living standards during this period (Jackson, 1986).

The regional growth rate fell from 4.8 percent in the 1970-75 period to 2.5 percent in the 1975-1980 period. It fell further to 1.4 percent in the 1980-1985 period (Alton, 1989). Regional figures, of course, obscure the performance of individual countries.⁵ The five countries of interest can be grouped into two categories in terms of GDP growth over this fifteen year period; the first consists of Poland and Romania, the countries that most enthusiastically pursued import-led growth and had the most foreign debt to repay. They exhibited higher growth in the first half of the seventies and registered a larger and earlier decline in growth connected with the debt crisis. The second group, including Bulgaria, Czechoslovakia and Hungary, realized more modest growth increases in the early seventies and a more gradual decline in output.

⁵ Note that these figures also include the GDR and Yugoslavia.

2.2.2. *The Eighties: The Debt Crisis and Slow Growth.* In the eighties, the effects of the debt crisis and the failed attempt to move to intensive growth lingered. The decade was a period of slow economic growth for the region. The need to service foreign hard currency debt meant that domestic consumption and investment did not grow significantly. In Hungary for example, most of the pain of adjusting to the need to service foreign debt in Hungary came at the expense of investment, rather than consumption. While for political reasons this was a sensible choice at the time, the cut in investment slowed the restructuring of industry, which slowed economic recovery. As in other countries, planners' attempt to increase hard currency earning by cutting Western imports hurt the performance of industries that depended on these inputs.

The efforts of the CEE countries to gain hard currency by increasing exports to, and decreasing imports from, the West were hampered by the recession in the industrialized West in the early eighties, which lowered imports to that region. Trade levels did recover in the latter part of the decade, but compared to other exporting regions, CEE exports to the industrialized West remained relatively resource-intensive (Woods, 1989). Thus, the import-led growth drive failed to alter the pattern of CEE exports.

One effect of the debt crisis was that planners reexamined their agricultural development strategy. The need to conserve hard currency meant that it was no longer practicable to import large amounts of Western grain in order to feed livestock. With the exception of Romania, the CEE countries embarked on agricultural reforms, including Hungary as the most aggressive reformer, and Czechoslovakia as the most reluctant.

These efforts are exemplified by Bulgaria's attempts to reform its agricultural sector in 1979 and 1986. In 1979, reforms included a vertical integration of the ministries responsible for links in the food production chain, from production to retail levels. A New Economic Mechanism (NEM) was introduced for agriculture; it sought to improve production efficiency by emphasizing the financial independence of enterprises and encouraging them to become more cost-aware. The reforms sought to improve the incentives facing individuals, by replacing mandated targets with the use of contracts among enterprises. These reforms were never fully implemented; there was a tendency for authority to be recentralized, and the goals of financial independence and hard budget constraints for enterprises was never enforced (Cook, 1986). This first set of reforms was not particularly effective in improving the performance of the Bulgarian agricultural sector. Output did not increase, and the agricultural trade balance did not improve. In 1986, Bulgaria implemented a second set of

agricultural reforms, which were oriented toward allowing enterprises to do more self-management and again reorganizing the bureaucracy responsible for agriculture (Cochrane and Lambert, 1989). These reforms were overtaken by political events before their success or failure became clear.

At the end of the eighties, then, the countries of Central and Eastern Europe were suffering from a common set of problems, including heavy foreign debt, a decade or more of slow economic growth, low-quality manufactured goods, an industrial sector that had experienced only limited investment after the end of the seventies, and a problem-plagued agricultural sector. While the severity of each of these problems varied by country, all experienced some combination of them. The new governments replacing the socialist regimes in these countries had to deal with a wide array of economic problems. They have done so with varying degrees of success.

2.2.3. The Nineties: Toward a Market Economy. While later sections of the paper explicitly address policy developments, this section seeks to give a brief overview of the CEE economies. In particular we present several production and consumption statistics for the countries concerned.

The economic decline of countries in the region, as reflected in their GNPs, slowed in the past year, and the OECD projects positive growth for 1994 in all countries excluding the Slovak Republic. Romania and Poland actually measured positive GNP growth in 1993, with provisional OECD estimates of 0.7 percent and 4.0 percent, respectively. The CEE countries all registered smaller declines in output than did the Baltic countries. On a less positive note, problems with currency overvaluations raised imports and decreased exports in 1993 in many CEE countries (Organisation for Economic Co-operation and Development, 1994). Continued high unemployment is also an issue.

In Bulgaria, the largest sectoral declines in 1990 and 1991 were in industry. While GNP sank by 11.1 and 21.1 percent, respectively, in those two years, industry shrank by 17.3 and 38.0 percent. Agriculture realized smaller losses of 6.7 percent and 7.3 percent (Alton and others, 1992). In general, for 1990 and 1991 industry sustained larger declines than agriculture in all five countries.

In addition to the uncertainties surrounding privatization and restructuring of agricultural production, producers in most countries have experienced an adverse turn in their terms of trade. Subsidies for production have largely been removed, and commodity prices have fallen, while input and consumer goods prices have increased. The removal of consumption subsidies, and inflation in general, have also somewhat reduced domestic food demand.

TABLE 6. Bulgaria: Production, 1970-1991 (thousand metric tons)

year	cereals	milk	tabacco	cheese	wine	cotton	wool	paper
1970	6789	121.9	1633	130	409	73.7	24.3	232
1971		119.9			409			
1972		158.1			379	78.8	27.1	255
1973		141.5			521	80.2	29	261
1974	6608	144.9		140	444	79.7	30.5	304
1975	7706	161.9	1803	142	347	78.9	31.5	343
1976	8492	165.1		147	512	78.8	34	513
1977	7578	117.5		148	359	86.2	34.9	363
1978	7492	139.5		150	437	84.4	43	382
1979	8291	159.3		167	468	85.5	35.6	395
1980	7649	122.3	2218	154	409	87.4	36	427
1981	8451	133		164	486			435
1982	9967	149		174	574			442
1983	7932	112		187	455			445
1984	9251	140.8	2590	187	516			454
1985	5384	126	2537	181	386			458
1986	8492	126.1	2605	193	420			456
1987	7278	133.1		187	359			477
1988	7820	116.1		197	340			438
1989	9527	81.1		195	257			322
1990	8115	76.5		192	293			
1991	8918	74.1		181	293			

While overall agriculture is a more significant sector for the CEE countries than for industrialized Western countries, its economic importance varies across countries. The 1993 share of employment in production agriculture ranged from a high of 32.2 percent in Romania to a low of 6.5 percent in the Czech Republic (Organisation for Economic Co-operation and Development, 1994). Consequently, the importance of the nature of adjustment in agriculture varies for these countries as well, for both economic and political reasons.

2.3. Current Trade Policies. The dramatic changes in Eastern Europe and the dissolution of the Soviet Union have created new opportunities and challenges, including that of integrating the Eastern European countries into the international trading system. In the appendix to the paper we present an overview of recent policy developments for each country. As it shows, all the countries are pursuing a major trade liberalization by abolishing the state monopoly on foreign trade. In addition, in most cases, the principal direct controls over imports and exports were eliminated and tariff became the main instrument affecting their trade. Whereas integration into the international trading system requires trade reforms in the East, it also strongly depends on the restructuring of Western trade policies toward the region. Open access to foreign markets is an essential element

TABLE 7. Czechoslovakia: Production, 1970-1991 (thousand metric tons)

year	cereals	potatoes	meat	milk	cheese	sugar	cotton	wool	paper
1970	7248	4793	885	4978	95	735	113.9	45.5	766
1971									
1972							121.5	48.1	818
1973						730	123.6	49.4	846
1974	10388	4522			125	750	126	50.3	865
1975	9295	3565	1095	5562	140	780	129.1	52.6	964
1976	9173	4214			149	620	122.7	52.7	1038
1977	10315	3760			158	924	125.1	54	1061
1978	10953	3995	1174		166	885	128.9	53.6	1071
1979	9181	3725	1183	5966	169	908	134.1	55.1	1073
1980	10702	2695	1210		173	841	135.7	56.6	1114
1981	9403	3743			178	850			1201
1982	10277	3608	1123		187	700			1228
1983	11058	3177	1189		188	790			1231
1984	11984	3978	1231	6823	193	833			1237
1985	11775	3450	1247	6942	195	840			1259
1986	10805	3512	1254	7074	202				1255
1987	11777		1281		216				1273
1988	11907		1331		228				1266
1989	12047		1352		220				1305
1990	12567		1327		205				1307
1991	11853		1072		181				

in the transition of the Eastern European economies from centrally planned to market oriented. Yet despite multiple trade agreements intended to assist this process it is still far from certain that Western markets will open for Eastern European exports. Various factors influencing the process, especially in relation to the EU, will be discussed in later sections. In this section, we present an overview of trade patterns and policies since 1989.

2.3.1. The Role of Trade. The turmoil that has visited the economies of Eastern Europe since 1989 has been matched by upheaval in their external trading environment. During the 1970s and 1980s, most of the region's trade was internal or with the Soviet Union, coordinated by the Moscow-dominated Council for Mutual Economic Assistance (CMEA). Trade with the West, while important as a source of hard-currency and new technology, was small as a percentage of regional totals.

This arrangement collapsed in 1989-90 as CMEA disbanded, disrupting relationships that had traditionally defined trade flows. Within a few years, new institutions for handling foreign trade were to emerge, but in the meantime the transaction costs of export-import activities soared. At

TABLE 8. Poland: Production, 1970-1991 (thousand metric tons)

year	cereals	potatoes	meat	milk	cheese	sugar	cotton	wool	paper
1970	16202	50301	1825	15017	246	1542	207.8	84.4	873
1971		39801		15216	278	1761			
1972		48735	2064	15831	294	1846	211.9	87.4	1019
1973		51928	2270	16307	307	1823	214.8	88.8	1073
1974	22977	48519	2533	16735	330	1595	214.5	97.3	1126
1975	19558	46429	2420	16430	353	1847	212.3	102.7	1240
1976	20863	46951	2342	16573	353	1774	218.5	106	1241
1977	19399	41143			348	1810	219	106.5	1277
1978	21537	46648	2505		386	1743	224.9	107.5	1237
1979	17341	49572	2549	17004	381	1724	214.1	107.2	1156
1980	18336	26391	2433	16542	400	1155	217.3	106.7	1186
1981	19721	42562	1865	15318	355	1824			1125
1982	21166	31951	2154		297	1932			1182
1983	22099	34473	2056	16803	328	2141			1231
1984	24392	37437	2012	16511	366	1933			1257
1985	23741	36546	2236	15783	389	1841			1292
1986	25036	39000	2511	15783	413	1881			1327
1987	26060		2495		451	1820			1380
1988	24504		2544		471	1815			1448
1989	26958		2513		451	1939			1406
1990	28014		2609		333	1865			1065
1991	27861		2597		293				

the same time, upheavals in the structure of production *within* these economies caused a vertiginous drop in real incomes across the region, leading, in turn, to a drop in demand for imports. (The Soviet Union showed a particular decline in importance as an export market.) Pinched between sagging demand and rising transaction costs, intra-regional trade shriveled. The most notable trade development for this group of countries was a decline in intra-regional trade estimated to have been nearly 20 percent in value terms in 1990, more than twice the decline recorded in 1989, as noted in the recent GATT international trade review. This trend continued—indeed, accelerated—in 1991. In addition to a large terms of trade loss with the former Soviet Union, intra-regional trade declined in 1991 by 50 percent in volume terms (Organisation for Economic Cooperation and Development, 1992).

The countries of the region have responded to this challenge as if in concert, by looking for new export markets in the countries of the Organisation for Economic Cooperation and Development (OECD), particularly in the Western European countries of the European Union (EU, formerly the European Community) and the European Free Trade Area (EFTA).

TABLE 9. Romania: Production, 1970-1991 (thousand metric tons)

year	cereals	potatos	meat	sugar	wine	cotton	wool	paper
1970	10632	2064	772	409	449	109.1	35.7	463
1971								
1972						130	41.5	505
1973				611		14	46	531
1974	13550	4119		600	628	157	49.2	575
1975	15266	2716	1078	516	727	145	50.8	605
1976	19791	4788		561	967	165	55.8	605
1977	18613	4207		713	911	171	60.8	655
1978	18974	4465	1223	555	763	175	67.6	691
1979	19337	4562	1346	600	886	175		717
1980	20200	4135	1343	600	760	183		719
1981	19945	5470	1387	610	995			834
1982	19954	5222	1205	550	1307			802
1983	17666	5163	1396	450	949			806
1984	20045	5981	1244	600	1004			800
1985	19503	5927	1294	540	535			811
1986	19725	4857	1296	500	1185			816
1987	16889		1024	500	806			819
1988	19286		1173	430	642			819
1989	18379		1090	520	391			819
1990	17189			380	598			
1991	19270				600			

Exports from the CSFR, Hungary and Poland to the OECD increased by 41 percent, 22 percent and 15 percent respectively, in 1991 (Organisation for Economic Cooperation and Development, 1992). More than 70 percent of the export increase went to the Ec, 20 percent to the EFTA, 5 percent to the U.S. and finally 3 percent to Japan (Organisation for Economic Cooperation and Development, 1992).

The evidence regarding changing trade patterns is consistent with the findings of several recent studies (Hamilton and Winters, 1992; Collins and Rodrik, 1991; Baldwin, 1993). Although the studies differ in a number of respects, they all confirm the importance of international trade to Eastern European countries and the significance of Western Europe both as an importer and exporter. Moreover, they suggest that the collapse of CMEA trade is not a short-term shock, but rather a long-term shift (Ostry, 1993).

This reorientation has occurred for several reasons, both economic and political. These wealthier trading partners offer ready markets for goods, and can supply the sophisticated technologies these emerging economies need for their restructuring. Increased economic ties with the West has also

TABLE 10. Eastern Europe: Per capita consumption of meat, 1971–1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Total meat					
1971	43.6	73.7	59.5	56.1	
1972	49.0	75.8	61.5	59.3	
1973	50.0	76.7	63.7	62.1	
1974	51.6	78.4	66.2	65.6	
1975	60.6	81.1	89.9	78.4	45.7
1976	62.0	81.0	67.5	70.0	
1977	59.3	81.4	68.9	69.1	51.9
1978	61.1	83.2	71.2	70.6	
1979	62.1	84.0	70.5	73.0	62.0
1980	64.9	85.6	93.6	82.1	60.0
1981	70.9	86.6	95.5	72.3	
1982	72.5	79.5	96.7	65.3	65.0
1983	73.8	83.7	98.3	65.4	58.0
1984	74.5	84.8	101.2	63.6	57.0
1985	76.9	85.8	100.5	67.3	56.0
1986	78.6	87.3	101.2	73.7	56.0
1987	77.8	89.0	101.5	74.4	55.0
1988	77.0	88.0	101.0	74.0	52.0

been part of a more general political and security reorientation, attractive to countries emerging from a period of Soviet domination. Finally, these partners represent stability. Characterized by well-developed institutional arrangements for trade along market principles, they act as models for countries in the process of developing their own institutions. It is easy to underestimate the size and importance of this step, which includes the training of a bureaucracy skilled in the arcana of tariffs and commodity classification, and the development of entrepreneurial importing and exporting companies. Given their reliance on Western models in designing the form of their new trade *institutions*, it is perhaps unsurprising to find these countries simultaneously importing the content of Western trade *policies*.

Even as these emerging institutions reached for reliable trading partners, they had to learn to adjust to a rapidly-shifting environment. During the same period as their economies were in transition, the EU was engaged in substantial internal reforms, including especially an overhaul of its Common Agricultural Policy (CAP), while the Uruguay Round of the GATT was rewriting the rules of global trade. These were developments over which the CEE and Baltic States had almost no control, but which profoundly influenced their trading environment. The GATT is discussed in section 4, while CAP reform is discussed in subsection 3.4.

TABLE 11. Eastern Europe: Per capita consumption of eggs, 1971-1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Eggs					
1971	127	284	258	193	
1972	126	273	260	196	
1973	135	293	264	200	
1974	140	293	270	205	
1975	146	297	274	209	214
1976	149	294	270	214	
1977	171	308	308	214	238
1978	197	311	314	219	
1979	187	310	324	221	270
1980	204	316	317	223	270
1981	209	321	314	227	270
1982	217	324	307	200	270
1983	231	328	327	200	270
1984	236	337	320	210	270
1985	256	344	325	220	280
1986	256	346	318	209	295
1987	263	342	315	199	295

2.3.2. *Pressures for Protectionism.* Pressures for greater support and protection of Eastern markets are growing in part due to the trade practices used by many Western countries to protect their own markets. In fact, the new trade regimes are often designed to be more compatible with the Western ones. For instance, in Bulgaria pressures to increase border protection and to introduce impediments to export, especially for grain, have largely originated from its Ministry of Agriculture. The damage to producers' interests created by more than three years of constant changes in the foreign trade regime, and the resulting market distortions, have not figured largely in public and political debate. Those opposing export bans and export taxes are publicly discredited as speculators. Producers' behavior has also been confusing. The liquidators of the collective farms (who are also their managers) have not been motivated to lobby against official policy due to the uncertainty surrounding their own positions. The new farmers are few in number, dispersed and politically inexperienced. Additionally, few really understand the significance of the distortions caused by impediments to exports and imports.

Similarly, in the Baltics where the imposition of export tariffs was opposed by domestic producers, it seems that the better producer conditions achieved by adopting a less restrictive export trade policy have led policymakers to adopt a more restrictive import policy in order to continue to improve producers' welfare at the expense of consumers. However, the higher consumer prices that resulted have in turn led to pressure for a more complete trade policy reform.

TABLE 12. Eastern Europe: Per capita consumption of sugar, 1971-1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Sugar					
1971	33.0	37.5	34.5	39.6	
1972	31.6	37.7	35.5	40.9	
1973	33.0	38.6	37.1	42.0	
1974	33.2	38.6	37.7	43.9	
1975	32.5	38.0	39.4	43.2	20.3
1976	34.5	38.2	33.0	43.9	
1977	34.0	35.6	34.9	41.5	25.2
1978	35.0	38.3	36.4	42.7	
1979	34.2	38.5	36.0	43.9	28.0
1980	34.7	37.5	37.9	41.4	28.2
1981	35.1	36.9	35.5	33.4	
1982	35.1	39.6	38.0	41.7	
1983	35.4	37.8	35.6	45.0	
1984	35.7	37.5	34.2	45.0	
1985	35.1	35.4	35.3	41.3	
1986	35.7	37.5	35.4	41.1	
1987	35.0	37.3	39.6	46.1	

There are other political constraints within the CEE and Baltic states affecting the ability of these countries to take advantage of trade opportunities. Falling prices for agricultural products plus rising prices for agricultural inputs and consumer goods have led to domestic pressure to protect agricultural incomes. The CEE countries, led by Poland, have taken steps to reintroduce trade restrictions for agricultural goods. In addition to pressures from domestic producers, this process has been influenced by the example of CAP policy, which is heavily dependent on variable levies that control imports, and by budgetary constraints, which largely preclude direct CEE income supports for producers.

Poland is an instructive example of this process. Price deregulation in 1989 caught farmers in a price scissors, as input prices rose more rapidly than output prices. Pressure by farmers for government action led to the formation of the Agency for Agricultural Markets (known by its Polish acronym, ARR⁶), which was charged with the task of intervention buying to stabilize the markets. In 1992, this change was extended to the setting of minimum guaranteed prices for wheat, milk and rye. The actions by the ARR have been supplemented by the setting of tariffs on agricultural goods (including livestock, meats, dairy products, grains, oils and tobacco) by the Department of Agriculture.

⁶ Agencja Rynku Rolnego

TABLE 13. Easter Europe: Per capita consumption of grain, 1971-1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Grain					
1971	170	113	124	128	
1972	173	111	122	127	
1973	170	109	120	125	
1974	165	108	120	123	
1975	162	108	118	120	189
1976	164	108	116	122	
1977	157	106	115	121	
1978	159	108	115	120	
1979	159	108	114	120	183
1980	160	107	115	127	172
1981	159	109	113	121	180
1982	155	110	113	119	173
1983	150	108	111	118	173
1984	146	109	111	116	173
1985	144	111	110	118	174
1986	144	110	109	118	175
1987	144	112	112	118	175

Previous economic analysis of the forces underlying agricultural protectionism indicate that pressures in CEE countries to protect agriculture will not abate. A study by Honma and Hayami links an increased level of economic development with an increased level of agricultural protection. It is also linked to a declining share of agriculture in GDP and employment (Honma and Hayami, 1986). Swinnen supports these empirical observations in a two-sector general equilibrium model (Swinnen, 1994). Anderson predicts that CEE comparative advantage will eventually move from agriculture to manufacturing, while likely remaining in agriculture during the transition period (Anderson, 1992). Any movement away from agriculture as an area of comparative advantage will strengthen the pressures for protectionism.

2.4. Studies Regarding the Comparative Advantage of CEE and Baltic States. Many analysts have examined the comparative advantage of CEE countries, often using the European Union as their reference point. A common problem with the comparative advantage studies is the use of distorted pre-liberalization trade figures, which were affected by the relatively high level of intra-CMEA trade and the need of CEE countries in the eighties to obtain hard currency to pay off their foreign debt. This is especially problematic when revealed comparative advantage measures such as Balassa indices are used in conjunction with this data.

One objective of CMEA was to promote the integration of CEE countries and the Soviet Union

TABLE 14. Eastern Europe: Per capita consumption of vegetables , 1971-1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Vegetables					
1971	118	70	83	86	
1972	116	74	83	84	
1973	116	71	87	93	
1974	125	76	87	84	
1975	127	74	85	109	113
1976	114	71	84	99	
1977	123	75	86	96	124
1978	127	69	83	105	
1979	141	70		119	140
1980	125	66	80	101	140
1981	135	66	77	118	
1982	142	75	76	107	170
1983	127	71	78	103	170
1984	138	81	77	116	170
1985	127	75	76	105	170
1986	134	75	75	114	170
1987			79	116	170

through the use of specialization agreements. When the changes in the political environment beginning in 1989 led to the dissolution of CMEA at the end of 1991, these countries were left with excess capacity for producing low-quality goods that had formerly been exported to CMEA partners as well as consumed domestically. While analysts are split over the extent to which specialization agreements increased economic integration in the region, intra-CMEA trade has fallen dramatically over the past few years.

When examining the results of these studies, the issue of the use of pre-liberalization trade figures, as well as the potential for rapid change in CEE production through increases in total factor productivity, must be kept in mind. In general, the studies conclude that CEE countries will have a comparative advantage in agriculture, at least in the medium run. This is especially true when the EU, rather than world markets, is used for the determination of comparative advantage. The studies can be divided into two general categories: those that look at all CEE countries, and those that focus on an individual country.

2.4.1. General CEE Comparative Advantage Studies. Three studies that examine the comparative advantage of CEE countries as a whole generally agree that the region should exhibit a comparative advantage in agricultural production, although they differ on the specifics.

TABLE 15. Eastern Europe: Per capita consumption of potatoes . 1971-1988 (kilograms)

Commodity and year	Bulgaria	Czechoslovakia	Hungary	Poland	Romania
Potatoes					
1971	29	109	72	189	
1972	29	106	69	187	
1973	27	106	67	183	
1974	27	108	66	177	
1975	23	96	67	173	96
1976	25	100	64	173	
1977	25	92	60	168	
1978	30	88	60	166	
1979	27	86	60	160	
1980	27	76	61	158	71
1981	30	79	59	157	
1982	30	79	57	155	100
1983	31	79	58	154	100
1984	30	81	59	149	105
1985	33	78	54	143	105
1986	33	80	50	144	110
1987	28	73	50	143	105

Collins and Rodrik examine the effects of EU trade policy on CEE exports in light of their comparative advantage evaluation. They attempt to estimate the volume, direction, and composition of trade flows that should emerge after liberalization and integration of the CEE and FSU into the world economy. They find that, after liberalization, trade volumes for CEE countries should increase. Trade flows will be redirected toward Western Europe. CEE countries have a comparative advantage in agricultural goods, textiles and clothing, and steel. Unfortunately, the EC is likely to put up barriers to CEE imports of these commodities, but in any event liberalization of CEE ag trade will put great pressure on the EU's CAP program. The discussion of the composition of trade flows is based on the principle of "revealed comparative advantage:" whatever the CEE countries are currently exporting to the West successfully is likely to be exactly what they will continue to export successfully, as least in the short run (Collins and Rodrik, 1991).

Anderson examines the comparative advantage of CEE countries and the former Soviet Union in agriculture. He concludes that in the long run, the CEE countries will tend to have more of a comparative advantage in manufacturing than in agriculture. His analysis is based on a comparison of the endowments of these countries with those of other countries, and on an examination of revealed comparative advantage indices. He comments that input use in these countries is already high by world agricultural standards, as is food consumption per capita. Thus, no large expansion in supply or output should be anticipated. Anderson does not address the role of productivity

TABLE 16. Bulgaria: Value of exports and imports, 1975–1988 (million dollars)

Years	Value of Exports	Value of Imports	Agricultural exports	Agricultural imports
1975	4691	5408	840	539
1976	5382	5626	954	506
1977	6351	6393	1028	453
1978	7478	7651	1048	506
1979	8869	8514	1160	609
1980	10372	9650	1526	674
1981	10685	10779	1796	798
1982	11428	11526	1873	629
1983	12129	12283	1762	820
1984	12850	12714	1583	829
1985	13341	13647	1544	1077
1986	14169	15487	1613	1050
1987	14382	15650	1601	985
1988	14957	15368		

improvements in the longer-run comparative advantage of these countries. This may be due to his visualization of the path of the CEE region as moving it toward Western Europe, which has a comparative advantage in manufacturing, rather than agriculture (Anderson, 1990).

Hamilton and Winters use a modified version of the Anderson/Tyers partial equilibrium model of world agricultural trade to examine CEE agricultural trade. Initially, they use a gravity model to project patterns of CEE trade and identify areas of potential comparative advantage for closer examination. They argue that these countries have a comparative advantage in agriculture and labor-intensive goods (Hamilton and Winters, 1992).

The authors examine the effect of two trade liberalization scenarios on CEE agricultural trade. The first scenario incorporates a significant productivity improvement in CEE agriculture with the integration of these countries into the EU, leaving the CAP unchanged. Under this scenario, CEE agricultural production increases substantially, due to the price incentives of the CAP. Productivity improvements are not nearly as significant as the price changes in increasing production. Agricultural production in the current EU falls, and net exports for the newly integrated EU also fall, due to the specification of the unchanged CAP and the expense of export subsidies. The results of this study would somewhat overstate the effects of incorporating CEE agriculture into the CAP, due to the reforms in the EU that lowered agricultural support prices and began to require set-aside acres.

The second scenario considers the complete liberalization of world agricultural trade via a GATT

TABLE 17. Romania: Value of exports and imports, 1975-1988 (million dollars)

Years	Value of Exports	Value of Imports	Agricultural exports	Agricultural imports
1975	5341	5342	862	694
1976	6138	6095	948	908
1977	7021	7015	1291	841
1978	8077	8173	1283	902
1979	9724	10916	1346	1163
1980	11024	12685	1410	1430
1981	12367	12264	1320	1573
1982	11559	9745	1003	844
1983	11512	9643	840	752
1984	12646	10334	768	681
1985	12167	10432	791	587
1986	12543	10590	853	752
1987	14185	11000	867	578
1988	15674	11011		

agreement. Hamilton and Winters feel that CEE countries would be able to compete internationally in agriculture under these conditions. They point to the potential for productivity improvements in production agriculture and its supporting infrastructure, the effects of price liberalization and other reforms on input prices, and relatively low CEE rural wage levels compared to the EU to support their position.

2.4.2. Country-specific Studies.

Poland. There are several studies that address Poland's areas of comparative advantage. Policy-makers in Poland are especially interested in this issue, since they are considering the potential of strategic development through government encouragement of select industries. As one of the CEE countries farthest along the reform path, considerable attention is also being paid to the role of Poland within the EU, and where its comparative advantage would lie relative to current EU members.

Misala supports the general conclusions of Collins and Rodrik for Eastern Europe in the specific case of Poland. Using a revealed comparative advantage index, Misala establishes that at the time of liberalization, Poland displayed a comparative advantage in natural resource-based and labor-intensive goods, which after liberalization moved away from natural resources and toward technology-intensive goods. This trend is of course greatly affected by the changes in the FSU: Poland acted as an oil refiner in the CMEA trade bloc before liberalization. Misala identifies

TABLE 18. Czechoslovakia: Value of exports by commodity and destination, 1970-1991 (million dollars)

year	exports	nonfuel	fuels	manuf	EEC	EFTA	Eastern	Other Europe	USSR
1970					497	176	1 225		1 221
1971	4 248	398	158	3 692	530	216	1 353		1 323
1972	4 915	462	180	4 274	608	243	1 607		1 668
1973	6 035	565	228	5 234	850	306	3 744		1 917
1974	7 053	761	283	6 010	1 047	425	2 209		2 097
1975	8 383	707	448	7 227	1 075	417	2 741		2 764
1976	9 035	64	439	7 902	1 035	418	3 141		3 066
1977	10 302	763	495	9 044	1 174	526	3 455	394	3 536
1978	11 740	963	481	10 296	1 326	558	3 899	415	4 062
1980	14 891	1 438	899	12 554	2 039	964	4 172	606	5 287
1981	14 782	1 102	709	12 971	1 730	613	4 014	641	5 602
1982	15 694	1 134	799	13 760	1 644	887	4 111	675	6 379
1983	16 477	1 044	791	14 641	1 571	758	4 352	731	6 789
1984	17 153	1 108	795	15 250	1 659	743	4 400	2.62	7 448
1985	17 557	1 134	813	15 609	1 662	803	4 687	3.57	7 628
1986	20 457	1 254	724	18 479	1 997	864	4.9	5 825	8 894
1987	22 600	1 386	800	20 415	2 221	927	6.4	6 978	9 974
1988	22 305	1 368	789	20 148	2 373	826		3 514	5 008
1989	21 645	1 327	766	19 552	2 514	878		3 344	4 412
1990	17 955	1 101	635	16 219	3 030	920		2 042	2 989
1991	16 317	1 000	577	14 739					

agriculture as a potential area for increased exports. He argues that it is difficult to evaluate Poland's comparative advantage in agriculture based on events since 1989, due to the dramatic effects of reforms on this sector and the changes in Poland's position with respect to the EU and agricultural trade (Misala, 1992).

Jutte argues that the changes taking place in Poland's food production and processing sectors do not reflect its comparative advantage. Although he does not explicitly analyze why this occurs, he offers four reasons why sectoral developments may not reflect Poland's comparative advantage: trade obstacles; changes in the composition of demand due to changes in relative prices and availability of markets; economic restructuring; and foreign investment. Basically, he argues that if Poland is not engaging in free trade, then production developments can not be in line with those implied by comparative advantage (Jutte, 1994).

Jutte concludes that Poland shows a comparative advantage in rapeseed, fruits and vegetables, fish products, poultry products and to some degree meat products. He then compares this analysis with developments in the food production and processing sectors. Rapeseed's share of planted acres decreased by 13% between 1990 and 1992. Both the value of production and employment share

TABLE 19. Czechoslovakia: Value of imports by commodity and destination, 1970-1991 (million dollars)

Years	imports	nonfuel	fuels	manufacturs	EEC	EFTA	Eastern	Other Europe	USSR
1970					539	272	1 142		1 208
1971	3 941	1 192	431	2 318	599	295	1 204		1 358
1972	4 662	1 530	467	2 666	646	297	1 506		1 548
1973	6 137	1 939	596	3 603	839	432	2 032		1 840
1974	7 532	2 385	649	4 498	1 178	591	2 397		2 054
1975	9 106	2 526	1 215	5 365	1 302	649	2 969		2 922
1976	9 706	2 663	1 363	5 681	1 339	657	3 172		3 159
1977	11 187	2 983	1 694	6 510	1 486	823	3 563	314	3 787
1978	12 604	2 985	2 119	7 500	1 644	936	4 046	367	4 400
1979	15 148	3 564	2 592	8 205	1 894	957	4 375	458	5 061
1980	14 634	3 871	2 847	8 429	2 032	1 031	4 378	560	5 458
1981	15 492	3 373	3 431	7 829	1 623	587	3 960	647	5 850
1982	16 324	3 369	4 376	7 747	1 516	1 037	4 154	753	6 730
1983	17 078	3 190	4 931	8 203	1 457	978	4 396	727	7 538
1984	17 568	3 187	5 293	8 598	1 493	860	4 829	4.68	7 992
1985	23 490	3 945	3 586	10 036	1 553	937	5 053	5.46	8 071
1986	13 574	3 564	6 414	11 111	2 061	1 178	6.7	6 178	9 532
1987	13 270	5 275	4 795	13 420	2 485	1 337	6.4	7 124	10 158
1988	10 584	3 048	2 771	7 755	2 581	979		3 671	4 558
1989	7 947	2 980	2 709	7 581	3 199	1 224	4.5	3 325	3 241
1990	2 343	996	7 244	3 147	1 464	2.9	2 138	1 763	
1991	1 759	748	5 440						

for fish production and poultry production declined. For meat processing, the value of production increased, but employment did not. Fruits and vegetables alone were consistent with comparative advantage. In terms of export performance, however, all the above branches showed a significant increase in the value of their export share from 1985-1992. Short-term results were more mixed.

Jutte includes a discussion of previous work in this area which serves to highlight the sensitivity of comparative advantage results to method and data choices. Van Berkum and Ruttan examined the comparative advantage of Poland versus Hungary and the EC, and determined that Poland is most competitive in potatoes, rapeseed, sugar, and fodder. It is somewhat competitive, although less so than Hungary, in apples, meat and poultry. They also note that poor-quality processing plants seem to influence the results. Jutte offers rapid changes in trade composition and changes in EC policy as reasons why the results may differ for poultry and potatoes from his own results.

Kwiecinski does DRC calculations for Poland, relating it to the EC. His results, as summarized by Jutte, also differ from Jutte's. He finds that most Polish agricultural products are competitive on the EC market, except for broilers and hogs on high-protein rations. Polish products appear to

TABLE 20. Hungary: Value of exports by commodity and destination , 1970–1991 (million dollars)

year	exports	nonfuel	fuels	manufactures	EEC	EFTA	Eastern	Other Europe	USSR
1970					419	188	618		808
1971	2 500	758	29	1 713	378	144	745		873
1972	3 292	967	46	2 279	524	181	970		1 187
1973	4 479	1 395	50	3 033	773	277	1 377		1 491
1974	5 129	1 586	58	3 485	791	357	1 590		1 638
1975	6 093	1 712	123	4 258	765	298	1 758		2 367
1976	4 932	1 457	146	3 328	860	395	1 241		1 490
1977	5 840	1 722	179	3 939	1 028	389	1 494	412	1 774
1978	6 434	1 822	222	4 390	1 153	395	1 513	465	1 934
1979	7 938	2 163	333	5 441	1 625	515	1 921	453	2 228
1980	8 677	2 548	420	5 709	1 788	684	1 834	278	2 539
1981	8 712	2 708	413	5 591	1 498	659	1 735	515	2 911
1982	8 799	2 615	581	5 603	1 369	583	1 648	747	2 949
1984	8 560	2 404	739	5 418	1 419	755	1 570	456	2 577
1985	8 555	2 252	437	5 866	1 372	750	1 610	189	2 876
1986	9 157	2 340	368	6 450	1 599	793	1 852	148	3 100
1987	9 571	2 386	402	6 783	1 912	875	1 665	222	3 130
1988	9 931	2 686	298	6 947	2 250	990	1.3	1 695	2 741
1989	9 605	2 759	275	6 570	2 396	1 022	2.8	1 530	2 413
1990	9 588	3 022	296	6 269	3 106	1 150	3.3	1 070	1 935
1991	10 180	3 355	298	6 526	4 654	1 524	4.5	617	1 363

be much less competitive on the world market than the EC market, so it could compete as an EC member, but would not have much luck as an outside exporter. Within the EC, Poland seems to have an advantage in relatively labor-intensive products.

Hare and Hughes concluded, in a pair of studies using 1988 data, that Poland is competitive in meat, fish, dairy and poultry products, oils and fats, cereals products and tobacco products. This contradicts Jutte's results for oils and fats and cereal products. In general, Jutte's brief comparison with previous studies indicates there is a lot of sensitivity to the time period and data set used in the determination of comparative advantage.

Hungary. Michael, Revesz, Hare and Hughes (1993) calculate domestic resource costs (DRC) for various Hungarian industries in order to find out in which sectors its comparative advantage lies. They note that some distortions remain in the economy, so they use prices which differ from domestic prices (Michael, Revesz, Hare and Hughes, 1993).

The authors use five different scenarios to examine DRCs and comparative advantage. One uses

TABLE 21. Poland: Value of exports by commodity and destination , 1970-1991 (million dollars)

year	exports	nonfuel	fuels	manufactures	EEC	EFTA	Eastern	Other Europe	USSR
1970					629	201	889		1 250
1971	3 872	1 010	512	2 350	719	232	908		1 387
1972	4 927	1 285	651	2 991	925	301	1 164		1 816
1973	6 432	1 678	850	3 904	1397	400	1 643		2 081
1974	8 321	2 170	1 100	5 050	1 877	607	2 020		2 372
1975	10 289	2 684	1 360	6 245	1 924	755	2 592		3 240
1976	11 024	2 876	1 457	6 691	2 066	871	2 918	313	3 335
1977	10 666	2 782	1 410	6 474	2 286	861	3 110	371	3 882
1978	12 238	3 192	1 618	7 428	2 776	827	3 329	431	4 781
1979	14 082	3 673	1 862	8 547	3 346	960	3 543	422	5 744
1980	16 997	4 434	2 247	10 316	3 771	1 335	3 612	372	5 298
1981	13 249	2 001	1 285	9 962	2 509	778	3 104	292	4 298
1982	11 214	1 815	1 728	7 671	2 280	664	2 284	396	3 262
1983	11 572	2 106	2 012	7 454	2 623	691	2 247	383	3 611
1984	11 647	2 361	2 042	7 244	2 756	846	2 191	21	3 446
1985	11 489	2 453	1 801	7 235	2 597	790	1 849	1.26	285
1986	12 074	2 292	1 594	8 188	2 572	898	1 856	6.49	2 856
1987	12 205	2 602	1 374	8 229	3 146	1 143	1 675	14.94	2 600
1988	13 960	3 008	1 429	9 523	4 034	1 373	11.2	2 266	3 424
1989	13 466	3 055	1 308	9 104	4 406	1 466	8.5	1 889	2 799
1990	13 627	3 424	1 456	8 747	6 369	1 875	6.1	925	2 080
1991	14 903	3 745	1 592	9 566	8 269	2 103	3.5	871	1 635

unadjusted prices and does not account for quantitative export restrictions. One uses unadjusted prices and take account of export restrictions. The other three have different price adjustments. The authors include a lengthy discussion of their results, but only the agricultural and food processing sectors will be addressed here. The food processing sector had output-weighted DRCs ranging from 1.66-1.24 under different scenarios—all in the uncompetitive range. Within the sector, wine and wheat processing seem to be competitive, while meats, milk products, canning, milling, vegetable oil, sugar and liquor seem to be uncompetitive. Of course, the caveat is that it is difficult to get meaningful sub-sectoral comparisons, since the agricultural inputs are assigned a common price ratio, which seems unrealistic.

The agricultural sector, in contrast, was competitive under all scenarios, although only weakly, with DRCs from .944-.916.

The authors compare their results to recent trends in production and exports. Interestingly, food processing showed significant export performance improvements, which may be due to significant increases in total factor productivity since 1990. In addition, they note that they may have

TABLE 22. Poland: Value of imports by commodity and destination, 1970-1991 (million dollars)

Years	imports	nonfuel	fuels	manufactures	EEC	EFTA	Eastern	Other Europe	USSR
1971	8 673	1 374	806	2 273	712	2 171	1 164		1 425
1972	11 571	1 814	1 064	3 001	1 464	3 379	1 502		1 591
1973	11 861	2 676	1 570	4 427	2 132	690	1 919		1 880
1974	13 752	3 570	2 094	5 906	3 209	1 184	2 057		2 354
1975	14 312	3 660	2 147	6 054	3 506	1 565	2 289		3 177
1976	15 667	4 243	2 489	7 020	3 699	1 686	2 677		3 535
1977	17 095	4 416	2 590	7 306	3 484	1 514	3 007		4 246
1978	19 089	4 834	2 835	7 997	3 544	1 399	3 477		4 809
1979	15 476	5 275	3 094	8 726	3 594	1 479	3 533	380	5 498
1980	10 244	5 890	3 455	9 744	3 703	1 333	3 770	317	6 327
1981	10 500	4 339	3 100	8 036	2 461	639	3 137	319	6 445
1982	10 547	2 846	2 247	5 151	1 804	467	2 139	264	3 836
1983	10 836	2 273	2 759	5 558	1 780	712	2 367	316	3 896
1984	11 208	2 437	2 442	5 668	1 942	792	2 230	0.55	3 833
1985	10 844	2 316	2 405	6 116	2 110	900	1 966	0.13	3 270
1986	12 243	2 163	2 319	6 727	2 161	935	1 939	0.71	3 238
1987	10 277	2 325	1 872	6 647	2 456	1 065	1 739	0.27	2 679
1988	8 160	2 839	1 820	7 584	3 499	1 495	0.16	2 106	2 852
1989	15 757	2 311	1 309	6 657	3 514	1 509	0.15	1 449	1 859
1990		1 248	1 787	5 126	3 469	1 370	0.66	442	1 617
1991		2 409	3 450	9 897	7 748	2 265	1.05	759	2 191

underestimated current food prices due to changes in the EC policy regime.

The authors discuss the EC Association Agreement in light of their results. They note that the tariff reductions scheduled in the agreement will lead to a long-run comparative advantage that differs from the short-run comparative advantage, which they calculated. For agriculture and food processing, significant quotas will remain at least until 1996. However, these sectors and forestry are the ones expected to benefit the most from the agreements, since they currently face such prohibitively high tariffs.

The Baltics. In the short run, trade patterns are likely to reflect past patterns of production and trade, whereas in longer run, once property rights have been established, infrastructure improved and adjustments to world markets made, they are likely to more closely reflect their actual comparative advantage. Hence, in the near future, exports to the West will primarily consist of resource-based or simple labor-intensive goods, while exports to the East will include machinery, energy and raw materials.

According to a gravity model developed by (Sorsa, 1994), the West should absorb over 90 percent of Baltics' exports. The EU (dominated by Germany) would absorb almost half of the Baltics' total exports, followed by the EFTA with about a forth of total trade, and finally the CEE countries with a very small share of 2 percent. The share of the other Baltic states is less than one percent, and that of the other republics of the FSU 6 percent, despite their large physical size.

Most trade of the Baltics is likely to be inter-industry trade, in which factor endowments are important. The Baltics are very close to the world averages in their relative endowments of all three main factors of production—land, capital and labor. More importantly, they have one of the highest skill levels in the developing world. Their education levels are close to those of many industrialized countries—higher than those in Southern Europe, for example. High skill levels relative to per capita income suggest that the Baltics' comparative strengths lie in skill-intensive manufactures and services. Their closest competitors would be CEE countries, especially those in the Visegrad group, because of these nations' similar endowments. Beyond the initial adjustment period, Southern Europe and Northern Africa, other main beneficiaries of EU preferences regarding market access, should not be in direct competition with the Baltics. Skill levels in North Africa are very low and they are likely to keep specializing in simple labor-intensive manufactures much longer than the Baltics. Over time, as capital accumulates, the Baltics may start competing with the industrializing East-Asian countries. Among the latter only Korea has skill levels comparable to those of the Baltics.

2.4.3. Recent Trade and Comparative Advantage. Recent trade composition statistics indicate high sectoral concentration. In particular, food, iron and steel, chemicals, textiles and clothing comprised about half of all manufacturing exports from Eastern European countries to the EU. In addition, unprocessed agricultural exports are very important for Hungary and Poland (GATT, 1992). This particular sectoral composition of trade may be sustained, at least over the medium term. As (Messerlin, 1992) notes "recent exports reflect their existing industrial infrastructure, most of which will still be in place in the medium run, and will thus provide the bulk of the export revenues for the first half of the 1990s. Second, these sectors do have some, albeit limited because of generous export premium schemes, experience in exporting to OECD countries, having been present in these markets in the 1980s." This view has, however, been contradicted by other observer (Hamilton and Winters, 1992). have argued that the Eastern European countries may develop a comparative advantage in more technology-intensive sectors.

It appears that evaluations of CEE and Baltic comparative advantage are affected by the use of pre-reform versus post-reform trade data, the authors' assumptions regarding the path of development through the rest of the decade and beyond (especially whether these countries are expected to converge to the Western European model over time), and the method of analysis used.

In summary, these countries are undergoing a dramatic trade reorientation as part of the reform and transition process. This is due in large part to the weakening and collapse of the Soviet Union and its associated trading system. The Baltics are unable to rely upon input supplies from other former Soviet republics, which has dramatically affected both their industrial and agricultural sectors. The CEE states have dramatically reduced intra-CMEA trade and concentrated more on trade with the West.

A factor contributing to the pressures for reform in these countries was the failure of the import-led growth strategy of the seventies and the ensuing foreign debt and slow economic growth in the eighties. Their historical development has left these countries with an economy that overemphasizes heavy industry and lags behind the West in terms of productivity. This situation of changing trading patterns and an economy that did not necessarily reflect competitive advantages increases the difficulty of determining the areas of comparative advantage where they should be expected to do well internationally. The idea of agriculture as an area of comparative advantage for some of these countries is not new to the reform period, but in fact was explored in the early eighties after the failure of import-led growth. In any event, future development of the international trade of the area will be affected by factors other than strictly economic issues such as comparative advantage; as in the past, political issues will play an important role. One area where political and economic concerns coincide is the trade agreements signed by CEE and Baltic countries, both among themselves and with the EU. We examine these trade agreements in the next section.

3. TRADE OPPORTUNITIES

As part of their efforts to define their place in the world trading system, the CEE and Baltic countries have undertaken a host of trade agreements that seek to define and advance trading relations, both among themselves and with countries from other regions. These agreements are affected by the historical differences among the countries; the Baltics, for example, have much closer relations with the northern EFTA countries than the CEE states do, while the three (now

four) northwesternmost CEE countries, historically more integrated with areas now considered Western Europe, are now also the countries seen as those closest to full EU membership.

This section reviews the steps that the countries of the region have taken in the past five years to integrate themselves into the world economy, and points to some opportunities and challenges they face as they pursue further integration. We first review the trade agreements that the CEE and Baltic states have taken to increase trade amongst themselves, with the states of the Former Soviet Union (FSU), and with the West, including the EU and EFTA. We then examine some of the developments within the EU that will undoubtedly affect the trade opportunities for CEE and Baltic states, including particularly the recent reforms of the EU's Common Agricultural Policy (CAP). We conclude this section with an overview of political developments, both within the region and in the West, that pose constraints on economic integration. Our discussion of the effects of the Uruguay Round we defer to the next section.

3.1. Agreements Between Countries within the CEE–Baltic Region. While the main thrust of the trade initiatives launched by the CEE and Baltic States has been toward the West, with the goal of eventual accession to the EU, the governments of the region have also taken steps to soften the impact of CMEA's collapse on intra-regional trade. These efforts have borne fruit in the establishment of regional free trade agreements based on market principles. In addition to fostering regional trade and consequently regional wealth, the free trade areas these agreements create are also serving as 'institutional training grounds' for the government and private agencies that wish to foster trade on world markets in accordance with GATT principles. It is, perhaps, unfortunate how well these agreements are modeled on other regional free trade agreements, since they mirror other free trade agreements by singling out agricultural goods for far less liberal treatment.

3.1.1. *Central European Free Trade Area.* The most important of these establishes a new regional economic organization to be called the Central European Free Trade Area (CEFTA).⁷ In the CEFTA agreement, the countries concerned (Poland, Hungary, The Czech Republic and Slovakia) expressed a will to gradually develop a free trade area in accordance with GATT principles. The Agreement was signed December 1992 and came into effect on 1 March 1993 (Organisation for Economic Co-operation and Development, 1994).

⁷ sometimes referred to as the Visegrad Free Trade Area.

The Agreement applies to both industrial and agricultural products. However, the effective extent of mutual concessions for these two commodity groups is clearly disproportionate. Development of a free trade area within CEFTA is concentrated mainly on industrial goods, while agricultural products are subject to so-called 'selective liberalization,' affecting only a small group of products, for which there will be a partial lowering of existing trade barriers.

The Agreement applies only to products of CEFTA origin. In the case of industrial goods, no new import tariffs are to be introduced in trade between the countries concerned, while reduction of existing tariffs will proceed at varying speeds within three commodity groups. For goods in the first group, comprising raw materials and most finished goods, tariffs are to be lifted on the day the Agreement comes into effect. For goods in the second group (lighting equipment, medical supplies, ceramic products), tariffs will start being phased out in 1995, and will be completely eliminated by 1997. The third group comprises more sensitive goods (textiles, steel products) for which tariffs will be phased out over seven years.

The process of liberalization of trade in industrial goods also embraces non-tariff barriers. The parties laid down the general principle that the elimination of such barriers would proceed according to the formulas adopted in the signatory countries' Association Agreements with the EU. In particular, the parties agreed to not introduce any new non-tariff or other barriers, and that all charges with effects similar to import tariffs were to be abolished when the Agreement comes into effect. All export tariffs and charges with similar effects are to be abolished no later than by 1 January 1997. Moreover, application of exchange control, import and export quotas, and all other measures with similar effects will be forbidden.

In contrast to their fairly aggressive embrace of liberalization for industrial goods, the CEFTA countries made only limited concessions for agricultural products. The Czech and Slovak Republics and, to a lesser extent, Hungary seem intent on maintaining a protectionist stance (Wor, 1993).

The question arises, why does CEFTA single out agriculture for such illiberal treatment? Both official and informal sources suggest that this decision, like so many others, has been driven not by critical study of the relevant economics, but by the following syllogism: We want to join the EU; the EU practices interventionism and protectionism toward agriculture; therefore, we should do likewise.⁸

3.1.2. *Proposed Baltic Free Trade Area.* The three Baltic states signed an agreement of intent to establish a preferential trade area amongst themselves that would eliminate all export and import restrictions between them as of 1 May 1992. The agreement did not specify whether this was to be a customs union, with common external tariffs on both import and export sides, or a free trade area, without common external tariffs and requiring a system of certificates of origin. As of end of October 1992, however, no further action had been taken toward implementing the planned preferential trade area. Apparently, this inaction was due to the Baltic countries' preoccupation with the deterioration of their trade with Russia and the other republics of the former Soviet Union (Sorsa, 1994).⁹

3.2. *Agreements with the Republics of the Former Soviet Union.* As noted above, the collapse of CMEA, the break-up of the Soviet Union, and the economic turmoil in its successor republics have together caused a reduction or even disappearance of markets for CEE and Baltic exports, and disruptions of supplies for critical imports. While these effects have been important throughout the region, they are most pronounced for the Baltic states, the economies of which were heavily dependent on the rest of the Soviet Union for inputs such as energy, and as markets for finished goods.

Lithuania. Lithuania has started negotiating bilateral trade agreements with Russia and with some other republics. However, with the demise of the centralized trade regime, compliance with these agreements has proved increasingly difficult for all parties. By the end of 1992, shortages had developed in the supply of several vital imports. Intense efforts to prevent further decline in trade led to the affirmation and ratification of several existing trade agreements with FSU republics, and the conclusion of several new agreements. By the beginning of April 1992, trade agreements had been signed with Estonia, Latvia and nine of the twelve FSU republics. Proposals for agreements with the three remaining republics (Georgia, Moldova and Turkmenistan) had been prepared and initialed.

⁸ Consider, for example, that when the cream of Hungary's agricultural economic profession gathered to consider the direction of agricultural policy in the newly market-oriented economy, its members came to these conclusion: "... it is advisable to transform our export subsidizing scheme so that it will be functional in the comparatively long run, similar to the scheme of the European Community..." and, a bit later on, "... in addition to the import liberalization, the appropriate customs system and cream-off will, in future, serve to protect the interests of [domestic] producers" (Res, 1992). In the same vein, Poland has set for itself the goal that "no final bound duty rates in the [GATT MFN] Schedules are lower than the corresponding entries in the Draft Final Schedules of the European Union" (Plunkett and Maxwell, 1994). Other observers (Janda, 1994) have noted the prevalence of similar sentiments in the Czech Republic.

⁹ Lithuania has also concluded trade agreements with most former CMEA countries—Bulgaria, the Czech and Slovak Federal Republics, Hungary, and Poland—and with Cuba and China.

Trade with Russia under the bilateral agreement is based on two so-called 'indicative lists' of exports from Russia to Lithuania and vice versa. These lists comprise "the major types of products to be delivered in 1992, for which quotas are being established and licenses are being issued". Export products on the lists are identified by their product specification and the quantities to be delivered. Both parties commit themselves to "take measure to create the necessary conditions for the conclusion of contracts by authorized economic entities regarding the delivery of products and rendering of services at contractual, including world, prices". As the careful reader may notice, this commitment is quite general. In particular, the governments do not specifically guarantee delivery of the quantities on the indicative lists.

The Lithuanian government plans to implement its agreement with Russia (as well as those with other FSU republics) within the 'system of state orders.' That is, if enterprises produce goods from the list of products subject to these orders, they face domestic quotas. They must then sell a portion of their output on the domestic market and export another portion to honor the trade agreements.

The trade agreements with republics other than Russia also contain indicative lists of export products and volume targets. However, these agreements generally do not include specific provisions for implementing indicative list trade (such as state orders). Moreover, in contrast with the agreement with Russia, they do not commit the parties to deliver the agreed quantities at agreed prices (World Bank, 1993c).

Latvia. Latvia started to negotiate trade agreements with the republics of the former Soviet Union in late 1991, to help ensure supplies of critical inputs. However, in most cases the agreements were never finalized, or were not fulfilled.

Trade with republics of the former Soviet Union takes place either under an 'obligatory list' that includes the most important products traded between governments, or under an 'indicative list' that includes trade on an enterprise-to-enterprise basis. In particular, the agreement signed with Russia in February 1992 identified thirty commodities under the obligatory list for government-to-government trade. These include mostly meat and dairy products, gasoline, diesel oil, and natural gas. Trade agreements with the other republics of the former Soviet Union also involve indicative lists of export products. Under these agreements, until June 1992 virtually all exports were subject to export quotas and licensing restrictions (World Bank, 1993b).

Estonia. Similarly, Estonia concluded several trade agreements with republics of the former Soviet Union to assure supplies. In particular, as of early 1992 agreements were in place with Azerbaijan, Khirghizia, Russia and Uzbekistan, while a trade agreement with Ukraine was under negotiation. The unique feature of this last agreement is that it allows enterprises to negotiate their own prices and quantities, within the overall framework of the amounts agreed to by the two governments (World Bank, 1993a).

Prospects for Future Agreements. Various leaders in the newly independent republics have, from time to time, floated a variety of other proposals for free trade areas, or for other forms of economic and political union on the territory of the FSU.¹⁰ While these initiatives have often been announced with great fanfare by leaders well-placed to pursue them, they have by and large made little progress beyond the talking stage. Many have suffered from a lack of clearly focused goals, or have carried a whiff of Soviet restoration. Persistent distrust of Russian intentions has been a sticking point for countries only recently independent; for the Baltics particularly, discussion of economic ties is entangled with concerns over the withdrawal of Russian military forces and the status of ethnic Russian residents. But perhaps most importantly, such proposals for economic rapprochement with the relatively impoverished and moribund economies to the east may appear to the thinly-stretched CEE and Baltic trade bureaucracies as a mere distraction from the main game, their single-minded drive for accession to the European Union.

3.3. Agreements with the West.

3.3.1. *The EU's Gradualist Approach to Accession.* As noted above, the countries of the region view accession to the EU as a central development goal, and appear eager to conform their policy and institutional practice to EU norms. In response, the EU has adopted a gradualist approach, slowly deepening the relationship with each country as it makes progress toward the construction of a modern market economy. These moves toward gradual integration have been formalized in a series of agreements that grant increased access to EU markets, provide vital institutional and technical assistance, and, in some cases, pave the way toward full membership. While the terms of these agreements vary in slight detail from country to country, the stages are, in broad outline, as follows:

¹⁰ These include such recent initiatives as the attempt to form a 'Baltic-Black Sea Union' encompassing the Baltics, the six CEE states, Belarus, Moldova, and Ukraine; and proposals to form a 'Eurasian Union' that would include, but not be limited to, all CIS republics (Radio Free Europe/Radio Liberty, 12 August 1994c).

- (1) Extension of a Generalized System of Preferences (GSP). The EU grants GSPs to a number of developing countries, affording them access to EU markets at tariffs slightly lower than normal on a limited spectrum of goods. Since the EU already had a mechanism in place to extend GSPs at the time when the CEE and Baltic states began vigorous movement toward freer markets, extension of GSPs was a relatively straightforward first step on the path to fuller integration.
- (2) Conclusion of a Framework for Trade. These agreements focus on the institutional framework for trade. They extend EU assistance toward the training of bureaucracies conversant in the language of trade, and grant reciprocal recognition of enterprise operating licenses. All the CEE and Baltic states have signed some version of these agreements with the EU.
- (3) Signing of a Free Trade Accord. These agreements grant access to EU markets for most industrial goods, although they explicitly exclude 'sensitive' goods including steel, textiles and clothes, and agricultural products. All the CEE and Baltic states have such limited free trade accords in place, although details of the terms vary somewhat between countries.
- (4) Signing of an Association Agreement. Also called 'Europe Agreements,' these grant associate member status to the country. They go beyond trade issues to cover such issues as the movement of workers and capital. The standard that the EU applies, when deciding whether to extend associate status to a country, is that the transition to a free-market liberal democracy is well underway, and "past the point of no return."
- (5) Full Membership. Accession to the EU would imply free movement of goods, labor, and capital between these countries and current member states. Producers would have unrestricted access to EU markets in virtually all sectors, and would also be subject to the discipline of unconstrained competition from sophisticated Western enterprises. By the time of accession, each government should have in place institutions that conform to EU standards in all the fundamentals of a market economy, including functional markets in the factors of production (including land and capital); a functional legal system which provides for the enforcement of contracts; systems for enforcing EU standards with respect to health and safety; and so on.

Presumably, agricultural producers would become eligible for some forms of subsidization under the EU's Common Agricultural Policy (although the expansion of the current program, without change, to cover the entire region would appear prohibitively expensive for current members). In addition, as poorer and less-developed members of the community, CEE and Baltic states could expect to receive substantial community assistance toward

infrastructure development. While the EU has not fixed a timetable for full membership, the governments of the more advanced CEE countries (e.g. the Czech Republic, Poland) are redesigning their respective economies with the goal of being ready by the year 2000.

In addition to these emerging institutional arrangements with the EU, the region has also looked for links with other trading partners, including particularly the EFTA countries. We now turn to filling in the details of these various agreements, while deferring to Section 3.6 our discussion of these countries' prospects for full EU membership and the difficulties that lie ahead.

3.3.2. *Details of EU and EFTA Trade Agreements, by Country.*

The Baltic Countries. During the Soviet period, the Baltics were, as part of the USSR, subject to special trade restrictions aimed at communist countries. Yet while the other FSU republics remain among the least preferred suppliers in many OECD countries (Kaminski and Yeats, 1993), the Baltics have since their independence been granted substantial concessions in market access.

At the end of January 1991, Lithuania concluded a trade agreement with the EU committing the parties to grant each other Most Favored Nation trade status and eliminating (with some exceptions) specific quantitative restrictions on imports from Lithuania into the Union. By December of 1991, the EU Commission had proposed a Generalized System of Preferences covering all three Baltic states; these came into effect the following month. In May of 1992, the Baltics signed Trade and Commercial and Economic Cooperation Agreements with the EU (Organisation for Economic Co-operation and Development, 1994). These were targeted toward building the institutional framework necessary for trade in the Baltic countries. They provided for technical assistance to trade bureaucracies, and for the reciprocal recognition of company licenses.

Meanwhile, the Baltics were achieving trade arrangements with the Scandinavian members of EFTA that were, with respect to industrial goods, even more far-reaching. Bilateral free trade agreements have been in force since mid-1992 between the Baltics and Finland, Sweden and Norway.¹¹ These highly liberal arrangements provide for mutual duty-free access in industrial goods, with almost no exceptions or phasing-in periods. Trade in agricultural products and fish are subject to separate agreements.¹²

¹¹ For Finland the agreement was a continuation of the duty free access granted previously to the republics of the Soviet Union.

¹² The Baltics have also signed preferential agreements with the Visegrad countries, Romania, Bulgaria, Switzerland, Turkey and Israel, which entered into force in late 1992 and 1993. These agreements have some initial restrictions on market access

Recently, the economic and psychological successes embodied in these agreements appeared to be imperiled by a contemporaneous development: the movement by several EFTA countries to join the EU themselves. Austria, Finland, Sweden, and Norway have negotiated to join the EU as full members, with accessions beginning as early as January, 1995.¹³ Those countries that join would be required to bring their tariff and market access policies into conformity with those of the EU, which were, for industrial goods, not as open. The danger for the Baltics was that these countries would withdraw the generous access provisions they had previously granted, as they moved "behind the wall" of EU access barriers (Daniel Plunkett, 1994a).

These concerns were resolved when the Baltics signed free trade agreements with the EU on 18 July 1994 (Radio Free Europe/Radio Liberty, 19 July 1994a). Under these accords, the Baltics will have the same access to the entire expanded EU as they previously had to the Scandinavian market. This far-reaching agreement eliminates tariffs on all industrial goods, including steel and textiles, a concession not granted even to the Visegrad countries under the Association Agreements. The accord provides for 85% of trade to be duty-free by 1998, with the balance made up mostly of agricultural goods.¹⁴ These generous terms were granted not so much to please the Baltic nations themselves, but to satisfy the Scandinavian countries that joining the EU would not entail abandoning their commitments to their fledgling neighbors (Daniel Plunkett, 1994a).

As of this writing, the Baltics are negotiating EU Association Agreements (Radio Free Europe/Radio Liberty, 27 July 1994b).

The Countries of Central and Eastern Europe. The Visegrad countries of Poland, Hungary, and the former CSFR signed Association Agreements with the EU in December 1991; these went into effect on 1 January 1993 (Organisation for Economic Co-operation and Development, 1994).¹⁵ While these treaties go well beyond trade issues to such matters as the movement of workers and capital, the provisions of most immediate relevance relate to the phased reduction of trade barriers in an asymmetric manner. While the EU agreed to eliminate immediately barriers on some exports from Poland, Hungary, and the CSFR, and will extend adjustment of others over a five-year period, those

in sensitive products. In addition, Austria has granted the Baltics GSP treatment.

¹³ Austria's bid has already been ratified in a referendum, while the Scandinavian countries will vote on accession later this year. Assuming all four nations do accede, EFTA would be reduced to just three members: Switzerland, Iceland, and Liechtenstein. Its future as a viable trade bloc would then appear to be in considerable doubt.

¹⁴ Other restricted goods include such sensitive items as nuclear materials. Estonia was granted a few concessions on agricultural products, but these were highly targeted in scope and of negligible size.

¹⁵ On that same date, the CSFR divided into the Czech and Slovak Republics. The Association Agreements apply equally to these successor states.

countries¹⁶ will liberalize the majority of their markets from 1995 onward. In case of Poland, the EU eliminated tariffs on about 50 percent of industrial exports and introduced a gradual reduction on the remaining tariffs on a schedule extending over five years. GSP tariffs granted in 1989 on some 480 tariff lines will be gradually phased-out. In response, Poland eliminated tariffs on about 27 percent of EU industrial exports; the remaining tariffs will be phased-out over a five year period starting in 1995.

In 1993, Romania and Bulgaria also signed Association Agreements, in February and March, respectively (Organisation for Economic Co-operation and Development, 1994); these are still subject to parliamentary ratification.¹⁷

At the EU's Copenhagen Summit in June 1993, it was agreed that these six associates would eventually attain full membership (Organisation for Economic Co-operation and Development, 1994). Although the agreements did not, to the disappointment of the easterners, set specific dates or criteria for full accession, the clause was nonetheless an important concession, not granted to all associate members.

Undoubtedly, the Agreements will significantly improve market access for goods and services, and will also increase competitive pressure on domestic enterprises to adjust to world market conditions. However, for so-called "sensitive" products (including iron, steel, coal, textiles, and agricultural products), the timetables for fully liberalizing access are among the longest,¹⁸ and in the case of agriculture numerous special provisions, as well as general safeguard clauses, are retained. There are two general clauses that allow either party to protect against increased imports under specified circumstances. These clauses are considerably less stringent than the prototype GATT Article XIX and are, of course, bilateral rather than multilateral. There are also six safeguards specific to particular goods or to specific circumstances in the transforming economies. These permit the Eastern European governments to take 'exceptional measures' of limited duration for 'infant industries' or when "restructuring or facing serious difficulties particularly where these difficulties produce important social problems" (Messerlin, 1992).

¹⁶ or, in the case of the CSFR, their successor states

¹⁷ Pending ratification, an 'Interim Agreement'—comprising the trade section of the Association Agreement—defines the bilateral relationship.

¹⁸ The EU did agree at the Copenhagen Summit to accelerate by six months the reduction in import levies for agricultural quota amounts specified in the Association Agreements (Organisation for Economic Co-operation and Development, 1994). However, since most agricultural goods are produced on an annual basis, this acceleration is arguably of only slight import.

As Ostry points out, “this rich array of safeguards is loosely defined, essentially opaque, and thus open to virtually unconstrained administrative discretion. It provides little discipline for either sustained trade liberalization or, more seriously, for sustained policy reform in the transforming economies” and thus may both reduce market access to the EU and impede the transformation process. Ostry further suggests that specific GATT rules to discipline the use of the safeguards are needed (Ostry, 1993).

The centerpiece in the EU’s array of protections for agriculture is its Common Agricultural Policy (CAP), an enormously expensive system of rules and subsidies. Our next section describes this system, and explains why reform of the CAP would impact dramatically the chances and terms of accession for the CEE and Baltic countries.

3.4. Summary of CAP and of its Recent Reforms. The Common Agricultural Policy (CAP) is one of the most important EU sectoral policies. Its objectives were laid down in article 39 of the Treaty of Rome, signed by the Six in Rome in 1957. The Treaty of Rome provided for a common market, in which quantitative restrictions and custom duties on trade between Member States are removed and a common external tariff established. It incorporated major features of economic union, including free movement of labor, services and capital, and common rules of competition. The major goals of the CAP, as stated in Article 39 of the Treaty, were (1) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimal utilization of the factors of production, in particular labor; (2) to ensure a fair standard of living for the agricultural community primarily by increasing the individual earnings of persons engaged in agriculture; (3) to stabilize markets; and (4) to ensure adequate food supplies for consumers at reasonable prices (Tracy, 1989).

With the CAP in place the EC became a major exporter in agricultural and food products, moving away from its net importer position in the pre-CAP era. Despite (or perhaps due to) its significance, the CAP is often regarded as the most distortionary and expensive EC policy (Frohberg, Fisher and Parikh, 1989). Recent CAP budgetary expenditure information for the Community and the Member States indicate a substantial increase in EU expenditure for agriculture, accompanied by an increase in national expenditures (Commission of the European Community, 1993).

Confronted by international pressure and intra-community budgetary problems, EC Agriculture Commissioner Ray MacSharry put forward a proposal for CAP reform. Though it received a predictable amount of condemnation from agriculture ministers and farm groups (especially in France and Spain), in early July of 1991 it was accepted as a basis for discussion, and on July 22 a revised and more detailed version was made public (Westhoff, 1991).

The aims of the proposed reform were: "(1) to provide the Community's farmers with a new and more stable framework within which they can improve their competitiveness and their earning; (2) to redirect support to farmers in a fairer way which help control production, stabilize and support incomes; (3) to provide increased support for encouragement of less-intensive production techniques and better care of the environment" (Commission of the European Community, 1991).

There were four main issues feeding into the CAP reforms of 1992: the U.S.-EC debate over subsidized oilseed production, the Uruguay round of the GATT negotiations, the need to reconcile the CAP with the implementation of the Single Market, and the reform plan proposed by Commissioner MacSharry (Swinbank, 1993). At the time, internal forces, including budgetary concerns, were emphasized, but it appears that external factors were more of a driving force behind the reforms. For example, the original MacSharry plan would have linked compensation payments to current hectares, while the compensation scheme eventually implemented has a historical acreage base, ensuring that the plan is decoupled and thus fits into the GATT's 'green box'.

Currently, EU agriculture is operating under the CAP reforms of 1992, as modified by the 1993/94 price package. The basic elements of the reform plan followed the outline proposed by agricultural commissioner MacSharry. Support prices were cut for grains, protein crops, dairy and beef, with a general support price reduction of 33%; the support price for oilseeds was eliminated. Supply control measures were introduced for field crops, beef, sheep and tobacco. Farmers were compensated for the reduction in their support prices with per-hectare payments for field crops. These payments are made on acres required to be retired from production for supply control reasons. 15% of a farmer's cereal, oilseeds and protein crops acreage must be removed from production each year, although small (about 20 ha) farmers are exempt from this requirement. In order to reduce slippage, the EU reforms originally specified that set-aside acres must be different plots each year on a five-year rotating basis. Pressures from larger producers, especially in Britain, and environmental interests has led to the loosening of this requirement. Beef and veal intervention prices are to be reduced by 15%, and farmers are in exchange to receive per-head compensation. The support

price cuts for dairy were minor, with an effective price cut of about 5%. Pork, poultry, sugar, wine, fruits and vegetables were not addressed (ERS: Plunkett et al., report coordinators, 1993; Anderson, 1994).

In its present form, the program exhibits some characteristics of current U.S. farm programs. In return for withdrawing a portion of their crop acreage from food production, grain producers are eligible for a government payment that is dependent on average regional yield. Institutional prices were reduced from pre-reform levels, but intervention buying continues to place a floor on EU market prices, analogous to the way in which U.S. loan rates have placed an effective floor on U.S. producer prices. Both programs recognize and seek to promote the role of farmers as environmental stewards.

The program also differs from U.S. farm programs in important respects. Proposed intervention prices significantly exceed U.S. loan rates for grains and purchase prices for dairy products. Smaller producers are exempt from set-aside requirements and production of nonfood products is allowed on set-aside area. Direct payments are made to some livestock producers, milk-marketing quotas are continued, and no payment limitation has been proposed (Westhoff, 1991).

The CAP reforms were slightly modified in the price package of 1993/94. Per-hectare set-aside payments were increased. These payments are now decoupled from production incentives since they are based on historical yields. Export subsidies were reduced for dairy products. The EU did not make any significant policy changes in this package, but mostly adjustments to the previous year's reforms. Some anticipated changes, such as a reduction in the dairy quota, were postponed.

The reforms have not substantially decreased the cost of the CAP. \$38.6 billion were budgeted for agricultural price supports in 1993, a 10% increase over 1992 and a 36% increase over 1990 levels. \$41.4 billion were budgeted for 1994, although overruns are anticipated (ERS: Plunkett et al., report coordinators, 1993). The CAP reforms and adjustments have added to the cost of agricultural price supports. Currency adjustments also played a role.

3.5. Studies of EU Policy Reform and East European Agriculture. Current studies that address the effects of EU policies and policy reforms on CEE and Baltic countries fall into four main categories: studies that address the general effects of EU trade liberalization; studies that address the effects in agricultural markets of CAP reform; studies that examine hypothetical scenarios of closer EU/CEE integration; and studies that examine the effects of integration under the current

institutional arrangement, the Association Agreements.

In general, the studies agree that CEE agriculture would benefit from the liberalization of EU agricultural trade and reform of the CAP. Examinations of different integration possibilities tend to agree that CEE agricultural production would increase, while that in the EU would fall. The restrictiveness of the current Association Agreements, however, and strong forces working against CAP reform and trade liberalization in the EU, indicate that it may be difficult for CEE agricultural interests to capture these benefits.

3.5.1. Effects of EU Trade Liberalization. Generally, the studies discussed in this section agree that less-developed countries, including the CEE and Baltic states, would benefit from EU trade liberalization. They find that, in agriculture, net food exporters would be expected to benefit from a rise in world prices. One study, however, predicts that less-developed countries (LDCs) as a group would lose out from EU liberalization.

A general equilibrium study by Burniaux and Waelborek¹⁹ compares the results of free agricultural trade in Europe under two reference scenarios: one in which relative agricultural prices on the world market decline annually by 2.5 percent (low price scenario) to one in which they increase annually by 0.6 percent (high price scenario). According to their results, abolition of the CAP would lead to increases in the real incomes in the EC of 2.7 percent in the low price scenario, and of 1.0 percent in the high price scenario. The impact of this altered policy on LDCs is shown to be positive in the sense that real income increases and food demand is higher in these countries. A study by Matthews²⁰ comes to the opposite conclusion. Using a partial equilibrium approach to calculating the gains and losses from liberalized EC trade, and taking into account the impact on other countries, he arrives at the conclusion that the less developed countries would lose from the elimination of EC agricultural protection. However, to the extent that the countries under consideration are net agricultural exporters they would be expected to benefit from liberalization even with net losses to LDCs as a group.

Another study analyzes the welfare costs associated with the price policy of the CAP. Using the Basic Linked System of IIASA to quantify the gains and losses which result from a unilateral trade liberalization in agricultural products by the EC, it concludes that in the year 2000 (after an

¹⁹ as summarized in (Frohberg et al., 1989)

²⁰ as discussed in (Frohberg et al., 1989)

under two alternative scenarios: (1) a baseline scenario that continues existing policies in the EC and other major trading countries, and (2) a CAP reform scenario that incorporates proposed changes in EC agricultural policies, but continues existing agricultural policies in other countries. He uses the agricultural commodity models of the Food and Agricultural Policy Research Institute (FAPRI) and additional models of the Center for Agricultural and Rural Development (CARD) (CARD, 1991). The study concludes that the CAP reform scenario would result in a significant reduction in EC exports of cereals, meat, and dairy products, and hence in an increase in world prices for those commodities. Similar results were obtained using the ERS SWOPSIM model (Roningen and Dixit, 1991).

Another recent study estimates that, following CAP reform, world agricultural prices would rise about 2 percent while EC production would fall by an equal proportion. EC producers would lose \$4 billion in spite of compensation, but the EC would experience an economic welfare gain of almost \$5 billion. U.S. producers would likely benefit both in income and production terms (Roningen, 1992).

Josling and Tangermann, analyzing the impact of implementing the current version of the MacSharry plan (as adopted in May 1992), concluded that it does offer the basis for a significant change in the EC market balance, due to a sharp drop in production and an increase in consumption from lower market prices. Anderson examines the likely effects on food markets and welfare of some EFTA member countries joining the EC. A partial equilibrium model is used, assuming two plausible scenarios. In the first, the EC adopts the CAP reform, as announced in mid-1992, but all other countries continue with their current policies. In the second, EFTA countries lower their domestic food prices to those in the EC after the CAP reform has been implemented. According to the model projections, absorbing EFTA countries into the CAP reduces farmer welfare less than it increases consumer and taxpayer welfare in EFTA. The net benefit to EFTA by the year 2000 would amount to \$9 billion per year (in 1990 dollars), or about 1 percent of GDP. The benefit to the EC would be smaller, some \$2 billion per year. Welfare in the world as a whole would increase as a result of such a cut in EFTA's farm protection; in particular farmers outside Western Europe, including those in Eastern Europe, would benefit (Josling and Tangermann, 1992; Anderson, 1993).

Koester and Tangermann consider the replacement of the CAP with two potential agricultural policies. They compares the costs and benefits that would result from a free-market policy and a policy with no price-induced surplus on individual agricultural markets. He shows that in 1980 the

overall welfare of the EU would have been considerably higher if either of those alternatives had been adopted. However, the breakdown of the total effect reveals that such policies might not be politically attractive. First, if governments are most interested in raising farmers' incomes, they might compare the impact on farm incomes with the impact on the budget. The CAP raises farm incomes much more than budget costs. This holds true for all member countries. Thus the CAP is attractive because there is an 'invisible' transfer of income from consumers to farmers. Second, even those individual countries that care about consumer welfare as much as farmer income might prefer the present policy due to intra-EU transfers. For example, Denmark, the Netherlands, and Ireland are better off in terms of national welfare with present policies than with proposed alternatives because of the common financial system. For these countries, the cost to consumers and taxpayers is smaller than the gain to farmers (Koester and Tangermann, 1991).

They also analyze the efficiency of the CAP as an instrument for transferring income to the farming population. They notes that in the EU consumers and taxpayers together spent about \$46.1 billion for farm support but only \$30.7 billion of this was reflected in increased farm incomes, compared with the free-trade situation. Thus, EU member states on average had to give up \$1.50 in order to transfer \$1.00 to farmers. The corresponding ratio is even higher for the United Kingdom (2.07), Italy (1.87) and Germany (1.80), indicating that from their point of view the present policy is not an effective instrument for transferring income to farmers.

3.5.3. *Examining CEE-EU Integration: Eastern European Access to EU Agricultural Markets.* The studies included in this section focus explicitly on the integration of CEE countries into EU agricultural markets. These studies show results consistent with those in the previous section: EU producer welfare falls, CEE agricultural production increases, CEE consumers face price increases. Specific effects depend on the conditions specified for market integration.

Koopman and Cochrane use a formal model to estimate the trade effects of a more ambitious reform in the West combined with reform in the East. As in the models described above, liberalization in the East is represented by removing domestic price supports and shifting out supply curves by an amount consistent with closing one third of the estimated gap between Western and Eastern productivity. If Western markets adjust, but price distortions are not changed, there is a negligible rise in net meat exports from the East, and a 25 percent decrease in Eastern grain imports. If, in addition to reform in the East, the EC removes its domestic distortions, this causes Eastern meat exports to increase by 75 percent and grain imports to fall by a further 25 per cent. The

incremental effect of liberalization in the rest of the world has a small effect on meat exports, and causes Eastern grain imports to fall to a third of the base level (Koopman and Cochrane, 1991).

Glecker et al. estimate what would have happened had the CEE countries integrated into the EC in 1989. In this scenario, 'integration' implies that CEE countries adopt EC prices and enjoy productivity gains ranging from approximately 5 percent for corn, oilseeds and oilmeal to more than 10 percent for meat, wheat, coarse grains, and sugar. Adoption of EC prices causes significant increases in CEE consumer prices, relative to 1989. Producer prices for most commodities increase, reflecting the fact that in the late 1980's producers were largely protected in the EC to a much greater extent than in the CEE countries. For pork and poultry producers, on the other hand, prices fall by 30 and 17 percent, respectively (Glecker, Koopman and Tweeten, 1991).

Anderson examines the likely effects on food markets and welfare of the more advanced Eastern European countries' access to the EC markets being extended to include agricultural products. A multicommodity dynamic simulation model of world food markets is used. In the experiment, allowing the four Visegrad countries free access to Western European food markets is shown to benefit farmers in those countries far more than it would cost consumers there. The net benefit by the year 2000 would amount to \$37 billion per year, but only on the assumption that West European taxpayers fully cover the budgetary cost of supporting producer prices and disposing of the export surplus of these economies in transition. The latter would involve a massive transfer of \$47 billion per year, which would represent a rise of almost one third in the projected outlays by the EC and West European national governments on farm support programs at the turn of the century. The net welfare loss of this integration program, since it increases protection in Europe's food markets, would be over \$10 billion per year: every dollar this program would transfer to CEE farmers would cost Eastern European consumers 30 cents and West European taxpayers 91 cents, or a total of \$1.21 (Anderson, 1993).

In a recent study, Tyers uses a dynamic multi-country model to estimate the effects of a combination of several types of changes: unilateral reform of the CAP, productivity growth in the East and gradual accession of Eastern Europe to CAP. A reference scenario, which assumes that none of these changes take place, shows the ratio of production to consumption increasing in the OECD and decreasing in the East and in developing nations. Unilateral reform of CAP, without productivity growth in the East or integration of Eastern Europe, moderates this trend, but does not change its direction. World prices for most commodities rise (by 10 percent for wheat and 7

percent for ruminant meat); however, the price of non-ruminant meat (which includes pork) falls, as the decline in protection of other sectors causes producers to shift resources. Since pork is a crucial sector for Eastern European agriculture, this fall in price diminishes the net benefits Eastern European producers receive from unilateral EC reform (Tyers, 1992).

The phased extension of CAP to Eastern Europe moderates or reverses the price rises which result from unilateral reform. In particular, by the midpoint of the integration process (the year 2000), the price of dairy products falls by more than 10 percent. This drop is due to an increase in dairy production in Eastern Europe resulting from an increase in the protection of that sector. Tyers estimates that unilateral reform of the CAP would reduce costs by \$23 billion per year, but inclusion of Eastern Europe would lead to an increase in budget costs of about half that amount.

3.5.4. *The Effects of the Association Agreements.* The direct effects on Eastern European countries and the Baltic states of the CAP reforms are limited by their Association Agreements with the EU. We described the terms of these accords in Section 3.3; here, we review studies that have attempted to estimate their probable effects, with a focus on their relation to the CAP and to agricultural trade.

Given that the Association Agreements continue to place strict controls on agricultural trade, little room is left for CAP reforms to directly impact CEE agricultural trade with the EU in any significant way. This analysis is supported by a study by Kwiecinski examining Poland's comparative advantage in relation to the EU, which finds that while Poland can compete in agriculture as an EU member, it would be unable to compete for EU agricultural markets on an equal footing with other exporters.

A study by Padoan and Pericoli examines specialization patterns under an EU expanded to include CEE countries. Their study shows that CEE countries would have a comparative advantage in agriculture, as well as in textiles and steel. Some current EU members would lose their comparative advantage in these areas to the CEE countries; France, for example, currently displays a comparative advantage in agriculture. The southern EU members would benefit the least from the expansion. Since some of these countries are currently among the poorest in the EU, they may also be reluctant to have to compete with new members for Community funds. The authors say that Germany would benefit the most from an eastward expansion; this finding is supported by calendar 1992 trade statistics, which show that Germany is responsible for 54 percent of EU

exports to CEE countries, and 57 percent of imports (Padoan and Pericoli, 1993; ERS: Plunkett et al., report coordinators, 1993)

Tangermann estimates the short term effects of the Association Agreements on agricultural trade for Poland, Hungary and the CSFR. He calculates the value to these countries of the agreements as the product of the preference margin (the difference between the MFN levies and the levies under the Association Agreements) and exports to the EC of various commodities. The level of exports is taken as the import quota, where this exists, and in other cases as the 1990 level of exports. The calculated value of the Agreements, as a percentage of the value of total agricultural exports to the EC in 1990, is in the range of 3–5% in 1992. Since the quotas are scheduled to increase over time, this value should also increase. By 1996 it reaches 7 percent for Poland, 14 percent for Hungary, and 22 percent for the CSFR (Tangermann, 1992).

Tangermann notes, however, that these estimates exaggerate the probable benefits to the three countries for the following reasons. First, while the numbers above involve the all potential rents resulting from the Agreements, a substantial percentage of that total may be captured by distributors in the EC, rather than by exporters in the countries concerned. Second, the calculations are based on EC support policies prior to the announced CAP reform of May 1992. That reform is designed to reduce EC prices, causing the value of the preference margin to fall; this change could reduce the value of preferential access by more than one-half.

Another issue that should be considered is how CEE/Baltic trade liberalization will affect the potential for future CAP reform. More than one study noted that increased CEE agricultural exports will place greater pressure on the CAP in its current form, since the CEE exports will lower world prices and increase EU expenditures on agricultural export subsidies. This increased budget pressure will increase the impetus for further CAP reform, apart from any effect due to preferential trade arrangements. CAP reform will also be affected by the GATT agreements.

3.6. Prospects for Full EU Membership. As the studies in Section 3.5 make clear, full accession for the countries of Eastern Europe would create many economic winners, but also some losers. The uneven distribution of anticipated benefits from full integration gives rise to political forces that will undoubtedly influence the speed and terms of CEE and Baltic accession, and could potentially prevent it entirely.

We have already surveyed the *economic* factors that will impact on the accession question. Here

we synthesize this discussion with an analysis of the political factors that will come into play. We first discuss political concerns within the CEE and Baltic nations, and then analyze tensions within the current EU membership.

3.6.1. *Domestic Concerns.* Overall, the political landscape in Eastern Europe appears to be strongly in support of rapid accession. In CEE countries, there is a widespread feeling that EU membership is desirable; people want to look West for their trade relationships, rather than East. A poll conducted by the EU in CEE countries indicated that 68 percent of the individuals polled viewed the Association Agreements favorably, and 78 percent approve of future membership in the EU (ERS: Plunkett et al., report coordinators, 1993). These numbers indicate broad support in the CEE states for the further integration of Eastern and Western Europe.

Likewise, in the Baltics people tend to identify with the Scandinavian countries rather than with the other republics of the former Soviet Union, and would look to EU membership as insurance against the resurgence of an expansionist Russian foreign policy. Furthermore, there exists, as previously suggested (Sorsa, 1994), potential net benefits from Western integration for the Baltics—specifically, the large size and high incomes of the Western Europe and the likely complementarity of demand between the Baltics and most West European countries offer large potential for trade creation. Furthermore, Western integration offers substantial institutional and dynamic benefits for the Baltics. In particular, integration with a more developed partner exposes the less developed partner to modern laws and regulations and helps transfer technology.

However, there are important political and economic actors who stand to lose from the open competition that EU membership would entail, including the managers of enterprises in poorly developed economic sectors (e.g. food processing, banking) who are currently in position to extract monopoly rents. In this context, the Association Agreements themselves may contribute to political constraints; the Agreements allow CEE and Baltic signatories a lengthy period—up to ten years—to open their markets to EU goods. Langhammer, and Winters and Wang both note that this timetable allows enough time for rent-seeking lobbies to develop in these countries and oppose the planned lifting of tariffs (Langhammer, 1992; Winters and Wang, 1994).

On the whole, the political climate in the east appears favorable to westernization, with even the reconstructed former Communists of the region apparently taking the goal of eventual accession as a given.

3.6.2. *Concerns Within the EU: Widening vs. Deepening.* Prospects in the west of Europe are considerably cloudier. Among the actors who have reason to be apprehensive about eastward expansion of the EU, the most easily identifiable are, naturally, the potential economic losers. As our literature review bore out, CEE and Baltic countries would enjoy a comparative advantage over EU producers in several areas, including low-wage industry, some subsectors of agriculture, and, perhaps eventually, in some high-technology fields. Current producers of these goods can be counted upon to oppose CEE/Baltic accession, or at a minimum to demand expensive payoffs in return for their acquiescence.

This brings us to a second political constraint: the limits of the EU's communal budget. Already several times in recent years, the demands of EU programs—including, particularly, of the CAP—have forced member states supplement the EU's common budget to keep it out of the red. In this context, wholesale extension of the CAP, as currently formulated, to cover Eastern producers would appear to be an infeasible budget-buster. Yet any further attenuation of CAPs benefits to producers would, of course, meet with fierce resistance. Either this resistance would have to be overcome, or some specially formulated version of CAP would have to be developed just for the new members.

On a more abstract level, some analysts have voiced concerns about the effects of increased intra-EU transfers on the organizational flavor of the EU. Langhammer notes that including just Poland, Hungary and then-Czechoslovakia would dramatically increase income inequalities within the EU. With the admission of new, poor members, he claims, the EU could move from being an efficiency-oriented group to an equity-oriented group, with more political importance attached to distributional policies. Given that the current members are more affluent than the prospective members, this concern is potentially a serious drag on the accession of these countries to full membership (Langhammer, 1992).

These forces can be seen as elements in a larger, and largely philosophical, struggle between those who favor rapid expansion of the EU's current boundaries, versus those who would first attend to unfinished business in the EU's long-term program for greater economic and political union—a tension between the potentially conflicting goals of 'widening' and 'deepening' (Tangermann, 1994). On the one hand, the Union genuinely desires an eastern flank populated by stable democracies that pose no security threat and are economically well-off enough to serve as an export market for EU goods. Proponents of rapid widening, led by Germany, argue that the best, and

perhaps only reliable, way to insure that outcome is to integrate these neighbors fully into the community.

On the other hand, the EU is in the midst of a long process of increasing integration amongst its members, a process that includes such profound stages as the creation of a common currency and the construction of a Europe-wide high-speed rail network. Proponents of deepening look to complete these connections among current members before seeking to assimilate another new group of countries. Unfortunately, the more integrated the economies of the EU member states become, the more difficult it will become for aspiring members to meet the Union's increasingly strict requirements for membership.²³

While some analysts argue that the two goals are not, in fact, mutually exclusive, Tangermann argues that they are, since they require contradictory structural adjustment on the part of current member countries (Tangermann, 1994). This analysis lays open the possibility that the CAP reforms, thought to aid the membership quest of CEE countries by reducing the budgetary costs of accession, may hinder the process by forcing structural adjustment in the agricultural sector in western Europe and solidifying the opposition to the liberalization of agricultural trade with CEE countries.

At the policy statement level, the wideners won a victory at the Copenhagen summit of June, 1993, when the EU governments agreed on the principle of eventual membership for all six CEE countries. However, since no schedule was set for the accession process, it may be that the deepeners won the more significant victory. If these forces prevail, then CEE countries may have their opportunities for EU membership delayed, or even scuttled.

From the discussion above, it is apparent that political pressures will play an important role in the movement of the CEE and Baltic countries toward EU membership. These countries seek to aid their eventual integration by developing trade policies and institutions that resemble those of the EU; this trend is encouraged in the actual Association Agreements. The influence of the Western model can be seen in the structure of CEFTA and other non-EU trade agreements as well; agriculture, for example, is virtually excluded from CEFTA as an area for freer trade.

²³ For example, should a revived ERM eventually lead to full monetary union, new member states would be required to adhere to rigorous ceilings on the size of their government deficit as a percentage of GDP; these are standards that even most current members fail to meet.

The premise that the CEE and Baltic states will continue to move toward the West in terms of trade policy, especially for agriculture, and toward greater agricultural protectionism, is not necessarily a foreordained one. Another change in the international trading environment was instituted last year with the conclusion of the Uruguay Round. The GATT agreement on agriculture could potentially provide a counterbalancing force for freer agricultural trade. The implications of GATT for CEE and Baltic agricultural production and trade are the subject of our next section.

4. THE GATT AND EASTERN EUROPE: EFFECTS ON AGRICULTURAL TRADE

On April 15, 1994, the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) came to a successful conclusion with the signing of the Final Act in Marrakesh. Except for their various trade agreements with the EU, this sweeping revision of the global trading system represents the most important recent development in the trading environment facing Eastern European countries. The agreement will expand dramatically the scope and depth of GATT, including agricultural products for the first time. New provisions on agriculture will not only affect Eastern European countries directly by imposing obligations regarding tariffs, export subsidies, and market access. They will also influence strongly the access these countries enjoy to EU markets, the conditions of their accession to the EU, and the terms of trade they enjoy when selling agricultural products in world markets.

In this section, we review the commitments that Eastern European countries have made under the GATT agreements. We then examine the impact of this agreement on the environment in which these nations will conduct their trade, both directly through their treaty commitments, and indirectly through the opportunities that other nations' commitments will create. We close with a discussion of two studies that attempt to estimate the importance of GATT-imposed liberalization, and of new research suggesting that such changes are far more significant than traditional theory suggests.

4.1. Summary of Uruguay Round Provisions on Agriculture. The general provisions of the Uruguay Round are well documented in several widely-circulated sources (United States Trade Representative, 15 December 1993; ERS: Plunkett et al., report coordinators, 1993). Rather than detail the overall agreements, we summarize here a few of the key provisions on agriculture most likely to impact Eastern Europe.²⁴

Tariff Rates. Signatory nations agree to abide by a system of Most-Favored Nation (MFN) tariff rates, whereby any tariff rate applied to a commodity from one other signatory nation is applied uniformly to goods from all other signatory nations. (The treaty grants some exceptions to this system to accommodate free trade areas and customs unions.)

Market Access. All quotas, variable levies (as used by the EU) and non-tariff barriers will be eliminated and replaced by a tariff equivalent to the protection afforded during the 1986-89 base period. These tariffs must be reduced by an average of 36% for all commodities and a minimum of 15% on any one commodity (24% and 10%, respectively, for developing countries).

Starting in 1995, a minimum of 3% of each country's domestic consumption must be imported, with this share rising to 5% over the six-year phase-in period (ten years for developing countries). If actual imports fail to meet this amount, tariffs must be reduced on quantities up to this amount. This lower tariff rate is called the tariff-rate quota (TRQ) rate.

Export Subsidies. All export subsidies will be reduced by 36% in value from the 1986-89 base period, with reductions phased in over six years (ten years for developing countries). In addition, the quantity of products subsidized (scope) must be reduced by 21%. Export subsidies may not be extended to products not subsidized in the base period.

Internal Support. Government support to domestic agriculture must be reduced by a total of 20%, in equal increments over the six years. Support is calculated not on the basis of expenditures, but on a computed "Aggregate Measurement of Support," which measures the spread between domestic and world prices. Depending on how world prices fluctuate during the phase-in period, required reductions in domestic support could be greater or less than 20%.

Sanitary and Phytosanitary Measures. While countries may continue to apply their own sanitary and phytosanitary measures, those stricter than the measures applied under the World Health Organization CODEX are subject to GATT review, and must be justified under scientific grounds if challenged.

4.2. Current Position of Eastern European Countries with respect to the GATT. Hungary, Poland, the Czech and Slovak Republics, Romania and Bulgaria all signed the Uruguay Round

²⁴ Details from (Sposato, 1994b).

Final Act on April 15, 1994 (Daniel Plunkett, 1994b; Daniel Plunkett, 1994a). All made commitments on market access (including the use of MFN tariffs and tariff-rate quotas), export subsidies, and internal support. Concessions will begin to be phased in starting during the 1995/96 marketing year. Romania, which was admitted as a developing country, will be allowed to phase in concessions over a ten-year schedule; the others will have to have their commitments implemented by marketing year 2000/01.

Bulgaria was given a form of recognition under the GATT in 1990. They signed the Final Act, but the details of their status with respect to the Uruguay Round is unclear at present (Daniel Plunkett, 1994a).

4.3. The Impact of the Uruguay Round on Eastern European Agricultural Trade.

While the full implications of the Final Act are too numerous and uncertain to be itemized, some conclusions are relatively straightforward. By and large, the Uruguay Round provisions will impose few important binding constraints on Eastern European countries in the medium term. The reason is based on a fortuitous technicality: the commitments that countries make under the Final Act with respect to market access, internal support, etc., are pegged to the values of these variables during a "base period," generally the average during the years 1986–88. During this period, the economies of the region were still governed by socialist principles, and were in most respects far more distorted than they are today. That is, the liberalizations undertaken since 1989 have in many areas already gone beyond what the GATT treaty requires. Nonetheless, the GATT commitments do impose an important long-term constraint, reducing the clout of CEE farmers who will, inevitably, lobby for increased protection in the future (Plunkett and Maxwell, 1994)

The far more important effects of the Uruguay Round provisions are indirect, mainly in the form of increased trading opportunities brought about by reductions in the distortions in other markets. We first consider the direct effects of the treaty, and then turn to the indirect effects.

Direct Impact of Tariff-Reduction Provisions. ²⁵

Direct Impact of Access Quotas. The mechanism by which GATT signatories assure the 3% (eventually, 5%) minimum access for imports is as follows: while most imports face a common MFN quota that is applied uniformly to products from all signatory countries, if a country is failing to

²⁵ Details from (Sposato, 1994a).

import the required minimum amount, the country will impose a lower tariff-rate quota (TRQ) on a specified quantity, which will remain in effect until the committed amount is imported.

But as Plunkett and Maxwell point out, "Opening a tariff-rate quota does necessarily expand market access, since imports may already exceed the TRQ. There is also the possibility of protectionism within the TRQ by settling the in-quota tariff rate too high for the trade to occur ... many countries, including the EU, used this method." As an example, Hungary is opening a TRQ for a quarter million tons of "cereal grains" at the eyebrow-raising in-quota tariff rate of 50%, only 10% below the MFN rate.

Direct Impact of Internal Support Commitments. The Uruguay Round calls for 20% reductions in Aggregate Measures of Support to agriculture, as measured from the levels in place during the 1986–1988 base period. The policy changes that Eastern European countries have put in place since then have already gone a long way toward achieving these reductions. Plunkett and Maxwell note that the Czech Republic has already passed its AMS commitment for the year 2000, and that Poland could actually increase its current levels of support. All the same, shifts in accounting practices, hyperinflation, dramatic policy changes, and informational problems in general make it somewhat unclear where all the countries of the region stand with respect to their AMS commitments.

Direct Impact of Export Subsidy Provisions. In this area as well, current practice is actually more liberal than the required GATT commitment. Although the Czech Republic, Hungary and Slovakia are currently using explicit export subsidies, allocations to these programs are dropping and are now below the amounts allowed under the Final Act. As Plunkett and Maxwell put it, "... it seems these countries are discovering how expensive it is to operate a system of export subsidies, and how inefficient it is as a means of supporting farmers' income."

Indirect Effects of The Uruguay Round on Eastern Europe's Agricultural Trade. As we can see, the constraints that the Final Act will immediately impose on the nations of the region are relatively mild. By contrast, the commitments that other signatories made should hold substantial benefits for Eastern producers.

The provisions on market access and internal support should open some major markets that had previously been virtually closed. In particular, these provisions should help to open EU dairy and grain markets, as well as those of other high-cost producers (e.g. Austria, Switzerland, Sweden, and Norway). Eastern European producers should be well-positioned to capture some of these markets

(Sposato, 1994a).

The provisions on export subsidies should also constrain the behavior of the region's wealthier competitors, to the benefit of Eastern producers. One major complaint of CEE governments toward the EU in particular has been that, just as these countries are trying to restructure and revitalize their agricultural sectors, the EU has been dumping large quantities of subsidized grain onto their markets and depressing the prices CEE producers face. Under the terms of the Uruguay Round, subsidized exports will be limited in quantity. Some major grain exporters, including the United States and the EU, will have to choose which of their export markets to target with the subsidies. It seems unlikely that the EU would expend its "subsidy quota" in Eastern Europe, rather than in other markets such as North Africa and China. CEE producers should see prices rise not only in their domestic markets, but also in other nearby markets such as the Middle East. As distortions are relaxed, patterns of true comparative advantage should emerge more clearly (Daniel Plunkett, 1994a).

Finally, the Uruguay Round would appear to enhance the chances of Eastern European nations to accede to the EU, for two reasons. First, while the EU's GATT commitments will hardly force revolutionary changes in the CAP, they do hold the promise of incremental reduction in CAP's cost. Now, although the EU has many reservations about the accession of eastern states that are related to the transition (i.e. that a fully-functioning market democracy be in place prior to accession), one of the main reservations that is not related to the pace of the transition concerns the huge expense that would be involved in the extension of the present CAP provisions to cover all the producers in the region. Indeed, it seems implausible that CAP provisions could be fully extended to cover Eastern Europe without substantial CAP reform. Thus, the Uruguay Round will tone down the budgetary reservations of the EU by forcing reductions in the CAP's expenses.

A second way in which GATT's reform should enhance the CEE's chances for accession to the EU concerns the export subsidy provisions. As we noted, these provisions are unlikely to impose binding constraints on the behavior of East European governments in the short run. However, if these countries were to join the EU, their limits would be added to those of other member states, to form a common pool that would then be reallocated via internal EU negotiation. The prospect of using untapped subsidy allocations could prove highly attractive to current EU members. This "dowry effect" (Plunkett and Maxwell, 1994) could help to overcome some of the resistance of agricultural interests in the EU to the accession of their eastern neighbors, although the need for

internal EU negotiations opens up an entire new set of issues.

Models of GATT's Impact. A number of observers have attempted to make more sophisticated estimates of the effects on trade flows, growth, and welfare of a successful conclusion to the Uruguay Round, sometimes combining this scenario with other developments (e.g. CAP reform, structural reform in Eastern Europe, East European accession to the EU, etc.). While the body of such studies is too large and fast-changing to allow for complete summary, we attempt here to give the flavor of the analysis with respect to agricultural trade and interpret the likely effects on Eastern Europe.

Roningen evaluates the impact of the Dunkel proposal, a plan for the liberalization of agricultural trade that laid the basis for the Final Act. Although his study focused on impacts in the EU and the United States, it still offers insights into the fate of East Europe's producers. Using the SWOPSIM model with 1989 data, he found that, following implementation of the Dunkel proposal, world agricultural prices would rise by 2 percent, while EU supply would decline by over 3 percent. EU producer incomes would decline by almost \$12 billion, assuming that support was removed without compensation (as was the case under the McSharry CAP reform proposal). Overall, the EU net trade position in agriculture would deteriorate by about \$6 billion. The EU would, however, gain \$4 billion of economic welfare, as benefits to consumers and taxpayers more than offset losses to producers. In addition, production and producer income in the U.S. would rise in response to the partial EU liberalization (Roningen, 1992).

The quantitative effects of the Dunkel proposal have also been analyzed by CARD (1992) using a dynamic world commodity model. This analysis does not include Eastern reform. However, even neglecting those changes, the analysis is interesting for its predictions regarding world price and trade flows, which have direct implications for the East. CARD compares the outcome under the Dunkel plan with a base scenario which assumes no reform. According to this study, GATT reform would lead to a 6 percent increase in world grain prices and a small decline in grain trade. The EU, however, shows a substantial reduction in its grain exports, as export subsidies are withdrawn.

4.4. Potential for New Goods in Trade Flows. The studies mentioned above are typical in that they take the current mix of goods traded as fixed, and look for adjustments in prices and quantities of those goods. Some authors have, however, cited the potential of the new trade regime to expand not only the quantities but the mix of traded goods. Hamilton and Winters

note the potential of Eastern Europe's well-educated population to begin production of more technically sophisticated goods than they currently export. Imports from the West should spur such technological development by bringing East Europeans into increased contact with sophisticated consumers, firms and technologies (Hamilton and Winters, 1992).

In this context, high tariff barriers are seen to reduce welfare, not only by constricting the flow of goods but by preventing important technology transfer. While Harberger estimated that the deadweight losses associated with the first effect are second-order small, amounting to only a few percent of GNP, Romer has pointed out that the welfare costs of the second effect may be far higher. Indeed, if tariff barriers are too high, potential importers of new production technology may be discouraged from incurring the expense needed to set up importing activities, as they become unable to recoup their fixed costs. The most important welfare effect of tariff barriers may, therefore, be not from the deadweight loss caused by a restriction of flows of a fixed bundle of goods, but from the adverse effect on production caused by the absence of technologies that are never imported at all (Romer, 1994). We are not aware of any empirical studies that attempt to detect or estimate the size of this effect – indeed, the effect would be extremely difficult to measure directly, since one would be trying to isolate the effect on production of goods that were *not* employed. However, given the urgent need for modernization of Eastern Europe's capital stock, it is plausible that the effect could be quite large.

With the exception of the Europe Agreements, the ending of the Uruguay Round is the most important international trade development affecting the CEE and Baltic states. While the direct effects of the Final Act on its CEE signatories will not be significant in the medium term, the indirect effects could be substantial. Minimum access provisions will aid in opening some previously inaccessible markets, and the limits on agricultural export subsidies may also aid these countries domestically by limiting dumping by the EU and others. By forcing CAP reform, the Act will potentially aid their accession efforts.

While GATT and the Europe Agreements affect CEE trade opportunities, domestic policies and associated political considerations will play an important role as well. Domestic policy directly affects sectoral development and reform, as well as creating the aggregate environment for economic decisions. Privatization, competition and foreign investment policies; policy sequencing and

irreversibility; and policy interactions will be discussed in the following section.

5. INTERDEPENDENT POLICIES

Although the agricultural sectors of the CEE and Baltic countries vary in terms of climate soils and major crops, there are a few stylized characteristics that they all share. Agriculture is a large share of GNP in these countries, and accounts for a significant percentage of employment relative to these figures for countries in the industrialized West. Generally, productivity levels are lower than those in the West. With the exception of Poland, agriculture was predominantly characterized by state and collective farms. Privatization, competition and foreign investment policies for each country are discussed extensively in the appendix. This section seeks to highlight some common features of these policies across countries and to consider possible problems arising from policy implementation and interactions.

5.1. Privatization and Agriculture. These countries are faced with the issue of how their agricultural sectors should be privatized and structured. The importance of this question in each country depends both on the size of the agricultural sector, relative to the economy as a whole, and on the historical patterns of organization. In most countries, the privatization and restructuring process has, for a host of reasons, treated state farms differently than collective farms. However, in contrast to many republics of the FSU, all countries in the region recognize the rights of land holders from the pre-socialist period to some form of restitution.

The co-operatives do not, technically, need to be privatized, since they already belong to their members. Many co-operatives simply re-organized as private co-operatives, sometimes dividing themselves into smaller units still organized as cooperatives. Although land restitution is, in these cases, not as much of an issue as it is with state farms, the division of cooperative shares to members often poses an accounting challenge: deciding whether to assign shares according to land contributions, labor contributions, or some weighted combination of both is typically a difficult question.

Different countries have approached the question of restitution differently. Bulgaria, for example, has sought to reunite each individual land claimant with his or her original pre-Communist plot. Hungary chose a partial compensation process through compensation vouchers, rather than returning actual assets. In general, restructuring of the co-operatives is progressing quickly, while

very little has been done regarding the privatization of state farms.

In fact, only a small proportion of 10 to 20 percent of cooperative members has chosen the path of independent farming. Politicians and experts offer different explanations for this fact; the most important reason, however, is that conditions supportive of private farming exist only in a part of the region. The peasantry's cautious behavior is thus an expression of sober and realistic judgement: for the present, private farming promises relatively modest income, relative to its high degree of risk (Csaki, 1994). In addition two important financial reasons have been offered for the slow progress regarding the privatization of state farms, including a shortage of domestic capital for the purchase of farms, and the extensive debts of the state farms, which make them unattractive to investors (Organisation for Economic Co-operation and Development, 1994).

In most countries of the region, very little discussion seems to have occurred regarding the ultimate structure of production agriculture.²⁶ In particular, although these countries entered the reform period with an agricultural sector heavily impacted by previous government involvement, current policy does not appear to be informed by any deep and critical analysis of the proper role for government. While some observers have tried to provide formulas that would guide government intervention in consistent direction,²⁷ the actual policy making process is often an ad hoc one. Another issue that has largely been ignored is the impact of the post-privatization structure of agricultural input and marketing/processing industries on the agricultural production sector.

5.2. Competition Policies. Regarding competition policies, most countries have enacted anti-monopoly legislation that use criteria such as market share and anti-competitive behavior. In this area, given that all countries have stated their intentions to promote competition by passing these laws, the true test will lie in the enforcement of these provisions. In the United States, for example, enforcement of the Sherman Anti-Trust Act and other competitive policies has ebbed and flowed with the philosophies of successive Presidential administrations. While it is too soon to draw any conclusions in this regard, early evidence from the Czech Republic indicates that competitive

²⁶ The exception is Poland. There, the loose consensus is that in the long run many small private farms will disappear and extensive farm consolidation will occur.

²⁷ Csaba Csaki, an economist at the World Bank, has outlined a modestly activist role, in which government would continue to play three roles: regulation, provision of support services, and information analysis (Csaki, 1994). Regulation would include food and seed inspection, establishment and enforcement of grades and standards, establishment and control of phytosanitary standards, epidemiology and livestock disease control. Essential public services to be provided by the government would include domestic and foreign market information, agricultural research, farm advisory services and higher education in agriculture. Finally, the government would monitor, review and diagnose the implication of changing circumstances and develop options for public policy.

regulation is largely ineffectual.

Competition policies are closely linked to trade policy, since competition for a domestic producer can come from abroad. In trade, as discussed earlier, the trend has been that these countries have opened their markets to foreign products, with a recent trend toward increasing agricultural protection. This trend is at least partially attributable to the use of the EU as a model for policy as these countries anticipate future EU membership. In competition policy, as countries look past the domestic market toward becoming members of the EU they may be more lenient in enforcing competitive measures against domestic producers, given that they will be facing more competition in the future.

There are other concerns involved with competitive policy. One involves the definition of a 'market'; often there may be a small number or even a single buyer of an agricultural commodity on a regional basis, even when there is a large number of buyers in the nation as a whole. If markets are defined strictly on a nationwide basis, then the laws may be less effective in preventing the development and use of monopoly power.

A second concern addresses the orientation of the enforcing agency, which may lead to differential enforcement for monopolists versus monopsonists, or for monopolists exercising market power against consumers versus those selling to producers, for example. The applicability of the competition provisions to non-contract cartels is something else that must be tested.

5.3. Foreign Investment Policies. In general, countries have opened their markets and loosened regulations on foreign investment in order to attract foreign capital. Common instruments include tax breaks and holidays, abolition of restrictions on the repatriation of profits, and a general loosening of regulations with regard to joint ventures and foreign companies. In spite of a general interest in attracting funds, however, the region as a whole has not found great success in doing so.

Why haven't these countries been successful in attracting foreign investment? One reason may be that there is competition from other countries and regions, such as the NICs of Asia, for investment capital. Another may be political and economic uncertainty in the region. Investors may be unsure that the region will continue to look favorably upon foreign capital.

An exception to this rule of general encouragement of foreign capital occurs in the case of agricul-

tural land.²⁸ Most countries restrict foreign ownership, both in Eastern Europe and elsewhere. This limitation on foreign control is an example of the special treatment accorded agriculture; like the defense industry in the United States, people fear foreign control. Domestic control of agricultural land helped ensure domestic control of the food supply, historically a concern for all countries.

The role of foreign capital in domestic political economy should be considered. How will foreign investors affect domestic policy? First, if governments are serious about attracting foreign investment, they may undertake policies that will signal their intentions to continue with reforms. Second, once foreign investors enter, they may seek to affect domestic policy in ways favorable to their own interests. In Brazil, for example, after its initial encouragement of foreign investment the first group of outsiders and their domestic partners united to form a coalition that pressured the government into preventing the entry of additional foreign capital.

5.4. Policy Irreversibility and Policy Interactions. The chosen reform path may itself lead to political constraints on future reforms. Unanticipated interactions among different types of policies may lead to unexpected consequences. Policies chosen early in the reform period may lead to the formation of interest groups with a stake in how later reforms will be designed, as happened in Brazil. Roland discusses how policy irreversibility can be exploited for both big bang and gradualist reform packages. Big bang policies do so by limiting the options of future governments with the immediate institution of reforms. Gradualist policies do so by building constituencies for further reforms with early ones, and by allowing the gradual resolution of aggregate uncertainty, which may result in less of a threat of political instability compared to the big bang (Roland, 1994).

In the case of the former Czechoslovakia, political constraints regarding the speed and sequencing of reforms, which had strong regional distributional implications, led to the separation of the Czech and Slovak Republics. As discussed above, early foreign investors may form an interest group that will affect later reforms.

The case of New Zealand may provide a cautionary example regarding the expected speed of transition; although policymakers chose a rapid reform process, the aftereffects of the 1984 changes lingered throughout the decade in agriculture and in the economy as a whole. This may have been due in part to the choice to deliberately slow the pace of reform in one area, the labor market. East European countries are facing a similar albeit starker choice between unemployment

²⁸ Estonia is the one exception to this rule (Organisation for Economic Co-operation and Development, 1994)

and enterprise restructuring (Lane and Lane, 1991). As countries proceed further along their reform paths without confronting the issue of an extended transition period, it is unclear what the consequences will be. This appears to be related to the question of EU accession, for example, as shown by recent European arguments that the CEE countries will not be ready for membership by the year 2000. If transition is slowed, so might be membership. CEE leaders who have used the drive toward accession as a motivation for reforms might find their domestic credibility undermined. More generally, the political reactions of voters disappointed by the speed of the transition and how it is affecting them might lead to a slowing of future reforms. Already voters in some countries including Poland have returned more old-line governments to power.

The policies discussed above, as well as trade policies and trade agreements discussed in previous sections, will all impact the economic and trade performance of the CEE and Baltic countries. None of these policies is imposed in a vacuum, and interactions among policies will likely prove to be vital to the actual development of these countries. It is extremely difficult to disentangle and predict possible policy interactions, but identification of some potential effects is possible.

Consider the way treatment of foreign investment interacts with competitive policies: CEE eagerness to attract and retain investors may lead to a relaxed enforcement of competition provisions. As discussed above, the anticipation of future competition within the EU may also lead to a relaxed enforcement of these laws.

The manner of agricultural privatization may interact with other policies, especially trade policies. Already in some countries agricultural interests have successfully pushed for the reintroduction of agricultural protection. A fragmented and inefficient agricultural sector could lengthen the transition process and act as a drag on the economy, which would give anti-reform groups more time to form and become powerful.

CEE and Baltic countries are at various stages of the reform process in regard to the different policy types discussed in this section. They have largely implemented competition provisions, but above the true measure of their commitment to these reforms will come in their enforcement. Privatization progress is more uneven, both across countries and within the agricultural production sector. More has been accomplished for cooperatives than for state farms. Foreign investment regulations have generally been liberalized and designed to encourage foreign capital inflows, but have not yet been particularly successful in the region as a whole. The interactions among these and other policies

and the speed and sequencing of reforms are expected to be vital to the eventual success of these measures and to the direction of trade policy.

6. CONCLUSION: THE ROLE OF POLITICAL CONSTRAINTS

During our preceding discussion of agricultural policy and performance, three themes have emerged: the importance of political factors; the powerful influence of the desire for EU membership on CEE policy; and the idea of agriculture as a unique sector.

Throughout our analysis, the importance of extra-economic political factors was apparent. The Soviet model of development placed an emphasis on industry, particularly heavy industry, at the expense of agriculture. One motivation for the CEE pursuit of import-led growth was to continue industrial expansion while also doing more to satisfy consumer demands. The desire of the Soviet Union to promote interdependence among its republics and satellites has strongly affected recent trade performance, particularly in the Baltic states.

Policy interactions and political constraints will be vital in determining the effectiveness of CEE competitive and foreign investment policies. Governments have enacted competition laws similar to those in Western countries, but the importance of these laws will be determined by how strictly they are enforced, which is unknown at this point. Laws enacted to encourage foreign investment have not yet had much success, in part due to the continued economic and political uncertainty in the region. Domestic political developments will affect the flow of foreign investment. The role that foreign investors will play in the region is still open.

Privatization policies regarding agriculture are an area of concern. State farm privatization has barely begun, while cooperative reorganization is much closer to completion. Issues such as land restitution policies and state farm debt have obscured larger questions such as what sort of structure is desirable for the sector, and what sort of role the government should play in guiding sectoral development.

While for the most part the GATT will have little direct effect on Eastern European trade policies, it will have important indirect effects, primarily increased trade opportunities resulting from decreases in protection rates for other countries and limits on export subsidies. The GATT agreement may aid CEE accession to the EU, both through the 'dowry effect' of unused CEE export subsidies and by forcing CAP expenditure reduction. The cost of expanding membership is a major

concern for the EU and any provision that reduces CAP expenditures should lower this barrier.

Most of the recent trade agreements signed with CEE countries, whether with each other or with the EU, largely exempt agriculture. This tendency parallels that of Western countries. The CEFTA agreement, for example, contains only extremely limited provisions for agricultural liberalization. The Association Agreements also largely exclude agriculture, although these do plan for eventual preferential access consisting of lowered tariffs on a quota of CEE agricultural exports. Both the GATT and intraregional bi- and multi-lateral trade agreements pale in comparison to the Association Agreements in terms of political-economic importance in these countries.

Many of the political factors we examined were related to the drive of CEE and Baltic countries toward EU accession. Countries are attempting to more closely align their domestic policies with those of the EU, as was endorsed in the Association Agreements. This tendency is also reflected in the language creating CEFTA, which eliminates tariff barriers in a manner specified to follow that of the Association Agreements. In general, recent movements in the region away from trade liberalization should not be seen as a retreat on the path to a market economy but rather as movements toward the Western economic model.

Like their Western counterparts, policymakers are designing agricultural policies that assume that agriculture is unique among economic sectors and merits special treatment. In part, this is due to the desire of domestic producers for protection from imports from more efficient competitors abroad and the general vagaries of the world market, but it is also because producer pleas fall upon sympathetic ears. Food security is a concern of policymakers, especially in Europe, twice-ravaged by world war in this century, and even more especially in Eastern Europe, where food shortages under socialism led to domestic unrest.

While the successful completion of the Uruguay Round gives some hope for reduced future levels of agricultural protection, CEE use of the Western model of agricultural policy and the desire for EU membership will be more influential in the region.

APPENDIX A. CURRENT TRADE POLICIES OF CEE AND BALTIC STATES

A.1. Poland. In 1990, the Polish government introduced reforms which changed the nature of the trading system. The package contained three major elements. First, administrative control over trade was loosened. The system of compulsory import and export licenses was abolished and with it the state monopoly of foreign trade. Other discriminatory treatment among enterprises was eliminated, uniform application of corporate and domestic turnover tax was established and an extensive removal of domestic price control and subsidies, including export subsidies, was implemented. Second, current account convertibility of the zloty was introduced, which meant that convertible currencies required for imports of goods and some services were directly available from Polish banks. Finally, nearly all quantitative restrictions on exports and imports were eliminated and customs tariffs have become the primary instrument of Polish foreign trade policy.

Tariff adjustments have been made frequently since then, in part reflecting the fact that Poland's tariffs are not bound in the GATT and could therefore be raised unilaterally.²⁹ The average tariff rate (frequency weighted) of 18.3 percent remained in effect during 1990. However, in order to lower the price of machinery imports needed for restructuring and to promote competition, the government chose to suspend many custom duties in part or in whole. Thus in March 1990, tariffs on 143 items were suspended and in August 1990, this suspension was extended to about 60 per cent of all tariff items. This resulted in the average tariff declining from 18.3 to 5.5 percent. Originally introduced for a short period, the suspensions were renewed to the end of July 1991. In August 1991, most of them were allowed to lapse, though they were extended for a limited selection of goods until the end of February 1992. The tariff schedule itself was revised at this time. These actions resulted in an increase in the average tariff levels with respect to both 1990 and 1989. Concerning sectoral averages, the most important change in comparison with 1989 was the increase in tariffs on agricultural products. Beyond this, reduction in tariffs on the plastic, wood and paper, machinery sectors more than offset increases for the minerals, chemical, and fur and leather sectors.

Although Polish trade policy now relies primarily on tariffs, certain quantitative measures still remain in place. The customs law specifies instances where import and export licenses may be required. In particular, import prohibitions and quotas may be imposed for cases which are consistent with the relevant sections of the GATT. Export quotas may be established to comply with

²⁹ GATT guidelines are set using the 1986-1988 period as a base.

international obligations and to avoid shortages in the domestic market. However, in general the reach of those quantitative restrictions on trade is limited (OECD, 1991-92).

In 1993, agricultural trade policy was influenced by an insufficient domestic supply of grains in the first half of the year and by a deteriorating balance of trade in agricultural products and pressure from farmers to increase protection against agricultural imports. As a result, most border measures were suspended as far as imports of grains and feedstuffs were concerned while for many other products import measures were tightened. In addition, in July 1993, new import tariffs were introduced with the aim of making the tariff system more compatible with the Western European one. Also, since July 1993, a newly introduced VAT is applied at the border at the rate of 7 percent for some imported products like potatoes, rapeseed and meat processed products, in addition to a tariff and a 6 percent import levy. In August 1993, Poland introduced a veterinary licensing system for imports of dairy products and in February 1994 it introduced countervailing charges modelled on the EU variable import levies. These charges are to be applied in addition to existing tariffs and are to be levied if the import price falls below a reference price established by the government.

A.2. Hungary. During the late 1980s, Hungary's foreign trade was completely liberalized. Import licenses were abolished (no license is required for an estimated 90 percent of 1991 imports). Customs treatment was unified, in January 1991, when the CMEA trade structures were dismantled.

Although Hungary has made considerable progress in liberalizing its trade, some trade restriction measures are still in place. In particular, Hungary has maintained quantitative restrictions on consumer goods, the so-called global quota. The value of the quota was gradually increased from \$100 million in 1984 to \$200 million in 1990, and the range of products covered was reduced, in 1989 and 1990. For 1991, this quota is set at \$630 million. Approximately \$150 million of the increased value of the 1991 quota is attributable to the incorporation of previous CMEA imports into the global quota. Other restrictive measures are confined to the foreign exchange restrictions as well, such as various import fees (OECD, 1991).

In 1993, the government introduced extra export subsidies for dairy products. These new incentives increased previous export subsidy by 30 percent for cream, powdered milk and whey and by 15 percent for raw milk and protein concentrate. Import licenses were reintroduced in January 1994. Their aim is to restrict imports in excess of 70 percent of the average imports of the last three years. Similarly, to help maintain the new market arrangements for wheat, export subsidies

have been reintroduced while a policy of export licensing is still retained. In addition to these measures, increases in export subsidy rates, which had been falling for the five previous years, were announced on a wide range of products, mainly meats and meat products, in August 1993. The rates, set as an ad valorem percentage of Hungarian border fee on board prices were increased typically by ten percentage points. The increases are said to be in response to the EU veterinary ban on animal and animal product exports in the spring of 1993. Unlike the ban, however, they continued at least until the end of 1993 and covered more products than those affected by the ban. These increases are further evidence that protectionist pressures are growing and are accommodated by the government. This expanded use of export subsidies is not consistent with a market-oriented sector and threatens the competitiveness of Hungarian agriculture by maintaining the sector in its current form when it should be allowed to adjust to the new market situation (OECD, 1994).

A.3. Czech and Slovak Republics. The Czech and Slovak Republics were still united for the early part of the reform period, and this unity is reflected in the organization of the appendices. While Czechoslovakia has liberalized its trading system considerably, it has also adopted certain transitional measures to guard against a surge in imports. In particular, in December 1990, an import surcharge was introduced. Initially, the import surcharge of 20 percent, calculated on the basis of custom values, was applied mainly to consumer goods. In April 1991, some provisions concerning the import surcharge were modified (exemption granted for goods imported for personal use by physical persons, for imports from Finland and for goods imported for production use). In May 1991, the rate of the import surcharge was reduced to 18 percent and then to 15 percent in June 1991. According to the authorities, some 15 per cent of imports are currently subject to the import surcharge. In the notification of the import surcharge to the GATT the authorities have declared that it should be considered as a temporary measure, which will be re-examined in the light of the outcome of the trade balance at the end of 1991.

In addition, in July 1990, licensing was introduced for certain categories of trade with the convertible currency area. This transformed the former system of implicit quotas and licensing into a transparent system with explicit prohibition and quotas. On the import side, the licensing concerns, at present, four categories (crude oil, natural gas, narcotics, arms and ammunition). On the export side, about 20 percent of merchandise export is presently subjected to licensing procedures. The present system of export licensing covers three main categories: sensitive goods (arms, weapons and explosives), items the import of which is subject to quantitative restrictions by partner countries

(in particular textiles, steel, and meat), some 125 food and intermediate products for which there is concern about the risk of shortages and excessive price increases in the domestic market (e.g. meat, cereals, sugar, cement, energy, wood). In September 1991, a global import quotas covering a few agricultural products (live bovine, animals, bovine meat, butter, potatoes, and margarine) was temporarily introduced. According to the authorities, this measure was taken because the very low present world prices for these goods are a cause of serious injury to domestic producers (OECD, 1991).

From January 1992, a new trade regime, designed for the new economic climate, was introduced into the former CSFR. The system is based on substantially higher custom tariffs, especially for sensitive commodities like agricultural products and food, and on import levies for selected agricultural products. Import quotas were abolished and import licenses made automatic and only for registration purposes. Export subsidies were used for selected products to help maintain domestic market equilibrium. This new trade regime, which in fact was designed mainly as a domestic market protection system, is roughly similar to that of the EU. Preferential tariff quotas were introduced for certain products covered under the Association Agreement with the EU in 1992. In addition, as a measure to protect domestic food supply, export subsidies were applied to beef, milk products and potatoes and import levies to live cattle, sheep and goats, various kinds of meat, butter, potatoes, grapes, sunflower and rapeseed oil.

According to the Customs Union Agreement between the Czech Republic and the Slovak Republic, mandatory co-ordination of these and other licensing policies of both states, as well as the list of products subject to licensing is required (OECD, 1994).

A.4. Bulgaria. Since the end of 1992 there have been several major changes in the Bulgarian foreign trade regime. The first substantial amendment was introduced in December 1992 and began the movement toward tariffication. The number of products for which there were import or export quotas were decreased and replaced by export and import taxes. It increased in the export tax on wheat, maize and wheat flour in order to discourage exports. A new regulation was introduced requiring the State to auction export quotas instead of allocating them among exporters. The second time the foreign trade regime was amended was in April 1993. The method of determining export taxes was changed from ad valorem taxes to absolute taxes quoted in US dollars per quantity units. The import tax, which previously was paid in addition to the customs duty and applied to agricultural products, and import duty were combined. A small additional

import tax was introduced on almost all commodities with the plan to phase it out by 1996. Higher seasonal import duties were introduced for tomatoes, cucumbers, peppers, grapes and apples. They were fixed at 55 percent for the MFN tariff. Some exemption of import duties within quotas were included, mainly concerning proteins for animal feed and agricultural machinery equipment.

After all these changes to the foreign trade regime had been taken into account, according to the Ministry of Trade, the nominal average Most Favored Nation (MFN) import tariff rate was 18 per cent, an average of 16.8 percent for industrial products and 25.9 percent for agricultural products. However 63 percent of agricultural imports attract an import duty of 40 percent and several non-tariff measures, in the form of test requirements, still exist for agricultural machinery and chemicals. Additionally, import quality controls were increased as a result of substandard products being imported onto domestic markets. Furthermore, as part of tougher trade legislation, new anti-dumping measures were adopted by the Bulgarian government. The most important of these measures is the provision of "emergency protection" for Bulgarian producers in case of injury caused by imports. Measures to implement this include import quotas, additional duties, import licenses and even the possibility of cancellation of existing import licenses. Another decree seeks to protect domestic producers from imports that are "dumped" or highly subsidized.

For 1994 no fundamental changes in trade policy were adopted. A few new provisions were proposed including the establishment on minimum export prices for exports to countries with minimum import prices or where some kind of reference price scheme exists. This will obviously have important implications with regard to EU trade. The foreign trade regime for 1994 involved compromising interests between producers and processors. For instance, in several cases the industrial lobby was successful in maintaining and sometimes increasing impediments to exports so as to keep their supplies at relatively low prices (OECD,1994).

A.5. Romania. Romanian trade was liberalized, in theory, by a law passed in 1990 which removed the state monopoly on foreign trade, but in practice trade policy is relatively illiberal. There are no import quotas, and for both imports and exports there are no license requirements, except when part of an inter-government agreement or clearing arrangements. In practice however, the government still plays an important role in foreign trade. To the extent that the Romanian government interprets that the domestic market situation is appropriate, agro-food exports and imports are being liberalized and trade monopolies are being broken up.

In 1993, agricultural trade policies were largely determined by the levels of supply on the domestic market. For instance, due to perceived shortfalls on the domestic market, export bans were imposed for cereals, wheat, rice, butter, and other whole milk products. Further, another decision was taken to make food product imports free of customs duty, for example, milk, cream, rice, barley, maize and soy. Many other agricultural product, especially inputs, are also imported free of tariffs, according to a law passed in December 1993 (OECD, 1994). In sum, Romania's trade is still dominated by the government.

A.6. Latvia. Latvia has taken many steps to implement an open competitive market with respect to imports. As of January 1992, it eliminated all controls on imports from any region, including licenses. Only small customs processing fees and no custom duties at all remained. More importantly, the right to engage in foreign trade was generally open to any firm and thus access to imports was relatively open and free from restraints. However, by January 1992, restraints on exports were still widespread. In particular, licenses were required for exports of timber, metal, scrap, cotton, all raw materials, and all food products to convertible currency areas and for all products exported to the republics of the former Soviet Union. In February 1992, export taxes replaced export licenses to the convertible currency area for timber and wood products. In 1993, Latvia introduced import duties either as ad valorem tariffs or specific rate tariffs (30 percent ad valorem tariffs were applied to meat and meat products, butter, rye and flour).

A.7. Lithuania. With respect to imports, Lithuania has taken many steps to implement an open, competitive market. As of October 1992 Lithuania abolished controls on imports from any region, including licensing. Only a minuscule tariff of 0.01 percent has been introduced that is applied uniformly to all imports to finance the collection of statistical information on trade crossing the Lithuanian border. In contrast, export quotas and licensing still abound. In particular, license is required for all products for which export quotas remain in place, including goods and services that are the subject to FSU trade agreements. In addition, export licenses are required for some products that are in short supply domestically. During 1992, Lithuanian authorities took important steps to liberalize this system by reducing the number of items subject to export licensing and simplifying the issuing of licenses. However, according to a government decree of October 8, 1992, most important food and energy products, as well as a few selected other raw materials and textile, metal and wood products are still subject to export licensing. These quotas and licenses are in principle applied uniformly for trade with all countries; a license is required for all goods subject to

export restriction regardless of the destination, including exports to the convertible currency area. In addition, a profit tax, containing components in convertible currency and in rubles, is required from enterprises exporting to the convertible currency area.

Furthermore, an extremely high export tax limits the amount of goods that a person can take out of the country. In early 1992, the amount of the export tax was 500 percent of the value of goods exceeding RUR 1,000. Some food products, such as sugar, butter and vegetable oil could not be taken out of Lithuania at all. However, a decree of August 11, 1992, essentially reduced the list of goods prohibited for exports without special government approval or license to standard prohibited products, such as arms, narcotics, articles representing cultural heritage and so on, with the exception of non-ferrous metals.

In March 1993, a new trade law was adopted to introduce further liberalization into Lithuanian trade policy. In particular, it aimed to implement a switch from non-tariff to tariff regulation of exports and imports. Import tariffs at 10% were announced on poultry, butter and eggs and export taxes were to apply to over 30 crop, livestock and food products. However, due to opposition, the law was effectively frozen for some months and previous trade restrictions remained in effect. Producer interests argued against the new measures, in particular, the export taxes that reduced producer prices. However, following debate, the law was revisited twice in July 1993 and finally, import tariffs were removed, but export taxes on some products (wheat and sugar beets) still remained. With the appreciation of the litas, in the second half of 1993, pressure grew to protect producers against cheaper imports, and thus tariffs were introduced on wheat and potatoes (15%), butter, other milk fat products, margarine, eggs, vegetable oil (20%) and sugar (70%).

A.8. Estonia. Estonia is essentially free of non-tariff barriers on imports. Moreover, tariff barriers are low. The Soviet system of customs duties was abolished in February 1992 and taxes on imports are basically limited to an administrative fee of 0.5 percent and excise taxes applied to the imports of restricted number of goods such as alcohol, furs, tobacco and gasoline. Regarding exports, however, several products were still subject to export licenses in mid-1992, although their number has been reduced from 201 in 1991 to 38 in early 1992. These products consist mostly of food items and raw materials, such as forest products, mineral products and cement. When a product is subject to export license it is licensed to all areas, including the convertible currency area.

APPENDIX B. PRIVATIZATION, COMPETITION, AND FOREIGN INVESTMENT POLICIES

B.1. Poland. In 1989 the economic situation inherited by Poland's new Solidarity government was extreme: hyperinflation caused by a complete collapse of budgetary discipline under the old government and rapidly falling production. In many respects this situation meant that there was no real alternative but to pursue a "shock therapy" economic stabilization plan. The Solidarity-led government, that came to power in August 1989, implemented the program that included tight fiscal and monetary policies, a large devaluation of the zloty to establish a competitive exchange rate, and full zloty convertability. It has taken steps toward private-sector development and has announced plans to privatize state enterprises. Government subsidies to producers and consumers were cut and wage increase ceiling was announced. The government implemented a major trade liberalization eliminating quantitative restrictions and relying on tariffs for trade protection (Rodrik, 1991).

B.1.1. Competition. The Antimonopoly Act of February 1990 (complemented in 1992 by the Act on Unfair Competition) established an independent Antimonopoly Office for investigation and enforcement of competition law (either in response to complaints filed by individuals and firms, or on the Office's own initiative) and gave it wide formal power with respect to both industrial structure and anti-competitive behavior. The Act specifies a number of monopolistic practices such as: (1) imposing onerous contract terms which yield undue benefits, (2) conditioning a contract on the performance of the other party of unrelated services it would not otherwise perform, (3) limiting market access of third parties, (4) direct or indirect price-fixing among competitors, (5) restriction of output, sales or procurement. If a firm holds a dominant market position the definition of monopolistic practices additionally covers market division, price discrimination, resale price maintenance, refusal to deal, and predatory pricing. For legal purposes, a dominant position is defined as one where a firm does not encounter substantial competition on the home or local market. An enterprise is presumed to have a dominant position when its market share exceeds 40 percent.

The Antimonopoly Office also has wide-ranging power to control industrial structure which goes far beyond the usual rights to investigate and control mergers and acquisitions. Thus Article 12 states that "state enterprises, cooperatives and companies of commercial law having a dominant position on the market can be divided up or liquidated when they permanently limit competition or conditions of its existence". Moreover, all proposals for the conversion of state enterprises into joint stock companies and for their privatization must be cleared with the office (OECD, 1991).

B.1.2. Privatization. Following a Parliamentary Act, all 1,640 state owned farms and land belonging to the National Land Fund were taken over by the Agricultural Property Agency of the State Treasury, by the end of 1993. However, because of the poor financial standing of collective agriculture, the demand for land is weak so land accumulated by the Agency has little prospect of being disposed of in the near future. By the end of September 1993 only about 25 percent of the land taken over by the Agency was sold or leased. The biggest problem facing the Agency is the indebtedness of state farms, which in September 1993 amounted to about US\$870 million. Moreover, the Reprivatization Law, which has been under discussion since 1989, has not been completed and accepted by parliament, although the government intends to put it into practice in 1994. The absence of this law is an obstacle to the restructuring and privatization of some state farms located in central, southern and south-eastern Poland, where former owners are claiming the right to land unlawfully taken from them by the Communist regime.

In 1993 more than 50 percent of processed food products originated from private and co-operative enterprises. Several of them are at a very early stage of transformation. However, in 1992, the government initiated several studies which have since identified the strengths and weaknesses of state enterprises within the sector and prepared the programs for their privatization. These programs were to start with sugar, poultry and potato processing enterprises and were later to be followed by meat and cereal. However, progress has been slower than expected and privatization takes place on case by case basis.

B.1.3. Foreign Investment. Poland initially opened to foreign investment in 1986, but results were very disappointing. In 1989, a new law sought to encourage more foreign investment through such policies as tax holidays and loosening currency conversion requirements. Regulations on profit transfers still exist. Domestic participation is not required in new companies, in fact, in the case of a joint venture there is a minimum share of the enterprise that must be held by foreigners to qualify for the tax and duties incentives (Economic Commission for Europe, 1991).

B.2. Hungary. In 1989 the Hungarian economy was substantially less distorted and more liberal than, for example, the Polish economy. The Hungarian government has been pursuing a gradualist program of economic reform since 1989. About 90 percent of all prices have been liberalized. The forint was devalued in early 1990, and made convertible. The government has taken steps to encourage private sector development, as well as domestic and foreign investment. Privatization of state enterprises is also underway. At the onset of 1991, the authorities presented a new four-year

programme of economic reform, entitled the Programme for Conversion and Development of the Hungarian Economy, which sets out the main guidelines of the government until 1994. The basic objectives were to confirm its previous intentions; that is, to strengthen the balance of payments, gradually reduce inflation, persevere with structural reform, and establish convertibility of the forint (Rodrik, 1991).

B.2.1. *Foreign Investment.* Hungary was the first country in Central and Eastern Europe to liberalize its foreign direct investment regime in the 1970s, and allowed foreign control of up to 49 percent of joint ventures. As a result, Hungary attracted foreign investors but the level of their investment remained low. On 1 January 1989, the Law on Non-Resident Investment came into force, enabling foreigners to exercise 100 percent ownership of Hungarian firms. The act permits the repatriation in convertible currencies of capital and profits. It provides for tax incentives for foreign investors. The differential taxation for domestic and foreign firms is also an inducement for domestic firms to reorganize themselves through joint ventures (OECD, 1991).

B.2.2. *Privatization.* As in other Central and Eastern European countries the restructuring of agricultural production in Hungary involves the breakup of collective farms or their transformation into true co-operatives. In the case of state farms, the process has been one of the privatization of state assets. Hungary has opted for a process that, while encouraging the development of private farming, hopes to avoid the problem of extreme farm fragmentation that has occurred in other countries. In the restructuring of agriculture, the issue of the restoration of former property rights has been prominent and contentious. Hungary opted to address this concern with a partial compensation process rather than a restitution of property actually expropriated. The process was operated through a system of compensation vouchers which may be used to acquire farm land in a land auction. The land designated for compensation was set aside in land funds by collective and state farms following the registering of land claims against these farms. By the official deadline at the end of 1992, 99 percent of the former collectives had re-established themselves as new co-operatives. Few members opted to take their land and other assets out and farm independently.

As far as agriculture is concerned, privatization affects mainly state farms and food industries. Apart from a small number of specialized state farms, one hundred or so state farms are to be wholly privatized in the same manner as any other state-owned industry. The restructuring of state farms involves two stages. Due to their size and diversity of activities, state farms were required to draw up decentralization plans. During this first stage, state farms are "transformed", i.e. divided into

smaller units with an independent legal identity potentially attractive to investors. The second stage involves these entities being "privatized", or sold (OECD, 1994).

B.3. Czech and Slovak Republics. Elected in the spring of 1990, the new democratic government inherited an economy that was relatively stable, mitigating the immediate pressure for economic reform.³⁰ The debt burden of 78 billion dollars was relatively modest. Inflation during the late 1980s was less than 2 percent per year, unemployment remained negligible. The new government's goal was to lead the country toward a market economy by means of carefully sequenced reform. The program was defined in three basic phases. The first was creation of the legislative and institutional framework required for a market system to function. The second, comprehensive liberalization of the price system, and the third opening the economy to competition by liberalizing trade, moving to make the currency freely convertible, and simultaneously beginning massive privatization of state-owned assets (Rodrik, 1991).

B.3.1. Competition. The Competition Protection Act, which became effective in February 1991, constituted the legal framework for protecting privatized enterprises from non-competitive actions. The law regulates cartels, mergers, and monopolistic or dominant market position. (a dominant market position is defined as a market share exceeding 30 percent). The law doesn't cover state monopolies that are subject to special laws (with the exception of public utilities like gas and electricity). The strength of the law is that it clearly defines unlawful actions and instances in which approval by the competition offices is required. In particular: (1) the law lists seven elements of cartel contracts which are against the law; (2) mergers are subject to approval if the merging enterprises have together a dominant position, (3) enterprises have to report to the authority when they achieve a dominant market position in the relevant market. The law lists four specific kinds of behavior which are considered misuses of market power; (4) during privatization, the privatization ministries have to set up clear conditions which will guarantee that the monopolistic position of privatized firms will be eliminated. There are, however, some aspects of the law that are not suited to Czechoslovakia's present situation. First, the definition of dominance may be unduly restrictive especially when applied to sectors where foreign competitors are in a position to contest the market. Second, the law fails to distinguish between anticompetitive horizontal agreements and vertical agreements (OECD, 1991).

³⁰ The two republics will be discussed in the context of the former Czechoslovakia as appropriate

B.3.2. *Foreign Investment.* Czechoslovakia has pursued an active policy to create the conditions for attracting foreign investment. The basis for foreign direct investment is the joint venture law of 1988, which was amended twice in 1990. The law is liberal in many respects. Joint ventures can be entered into by both corporations and individuals, foreign companies may take a 100 percent stake, joint ventures may be established in any sector except for those deemed important to "defence of the security of the state". Authorization is not needed in the case of 100 percent foreign ownership, or if the Czechoslovak partner is a private person or a co-operative formed after July 1988. Profit and capital remittance are not restricted since the establishment of convertibility in January 1991. Certain tax benefits are also provided to foreign investors relative to domestic enterprises, though on balance such advantages are less marked than in some of the other countries of the region (OECD, 1991).

B.3.3. *Privatization.* During 1991 and 1992, the laws on restitution of land and other agricultural policy, privatization and transformation, were approved by the former CSFR government. In particular: Land Law, which governs the restitution of land and other agricultural property to the entitled persons and to the establishment of new family farms. By means of this law it is possible to: for those citizens whose property was expropriated by the state after February 1948, as part of the land reform that has begun in 1918, and to take land from larger owners (over 50 hectares), to have the right to take over the ownership rights of such land and agricultural property; to re-establish ownership rights of all existing land owners or owners by inheritance, by giving back land and other agricultural property brought previously into a collective farm and from this basis to establish individual farms to establish ownership rights to land and other agricultural property by way of renting this property to its existing or new owners. Further, the Transformation Law determines the property shares of persons who own land and other agricultural property which was put in the collective and/or who worked in the collective. However, despite these two legislative pieces the situation with agricultural land restitution and privatization is still very fluid.

B.4. Romania.

B.4.1. *Privatization.* Restructuring in the Romanian agricultural sector began earlier and developed faster than in other sectors of the economy. Despite the speed in getting out of the gate, the process has proven extremely complex and time consuming. The majority of laws governing the process of privatization and structural adjustment were introduced during 1991, with some

amendments made since then. One of the earliest laws, the land law, was implemented in 1990 and resulted immediately in the breakup of more than 3,700 collective farms. By the end of 1993, in total, about 93 percent of agricultural land was "owned" by private entities. However, some of the practical results of the privatization process have been detrimental to the efficiency of Romanian agriculture. In particular, fragmentation of agricultural land has been a major problem, with the average size of new farms being two hectares. Another development commonly perceived as a problem is that over 50 percent of land was received by those outside of the agriculture sector. The land law allows for private associations to be formed in the various branches of the agro-food sector and for renting land but this does not seem to have developed significantly yet. However, the lack of possession of final title to land effectively prevents a properly functioning land market to exist in Romania. Consequently, most land sales and rental takes place on an informal basis. Moreover, subsistence farming traditions in Romanian agriculture are a further constraint on the development of commercially oriented farms (OECD, 1994).

B.4.2. *Foreign Investment.* Romania liberalized its regulations regarding foreign investment in 1990. Allowable fields for joint ventures were increased, and the participation of Romanian citizens in joint ventures was allowed. Previously, it was extremely difficult to invest in Romania, since all foreign investments had to meet a very narrow definition of national economic interest and survive a difficult and often arbitrary review process (Economic Commission for Europe, 1991).

B.5. Bulgaria.

B.5.1. *Privatization.* Bulgarian government decided to abolish collective forms of co-operation and change ownership patterns. The introduced measures were strongly influenced by considerations of equity, such that whoever contributed land, capital or labour to agriculture over the past four decades had the right to share the existing agricultural assets. The precision required to determine the share of each claimant in land and non-land agricultural assets is daunting. The procedure adopted, which is quite complicated, is to issue coupons on the basis of asset shares so that internal tenders can take place. Further, the 1992 Land Law required that agricultural land be restituted to the pre-1946 owners or their heirs. In addition the Municipal Land Commissions were given permission to issue final title to land. Although in 1992, an emphasis was put on the restitution of land ownership at the expense of privatization of state-owned companies, the Ministry of Agriculture made concrete plans for privatization of the up- and downstream branches of the agricultural sector

in 1993 and more general plans up until 1996. However, there is growing consensus that the privatization process has been too slow, leading in 1993 to amendments designed to simplify this process.

B.5.2. *Foreign Investment.* Bulgaria passed a new foreign investment law in February 1992, which aimed at promoting foreign investment as part of a more comprehensive economic reform program. According to the law foreigners can own commercial buildings and can even establish their own banks. In contrast, they can not acquire the right of ownership of any land including agricultural land. (OECD, 1994).

B.6. Latvia.

B.6.1. *Privatization.* The Latvian program for ownership reform comprises three stages: the first is to return state owned property to the municipalities which will be responsible for its subsequent privatization. This step was largely completed by mid 1992. The second is to return property nationalized or otherwise confiscated after 1940. The government has promised to restore such property to former owners or their descendants, or to pay compensation in cash, vouchers, or comparable property when the property itself cannot be restituted. Finally the third is to sell state and municipal property. In November 1991, a law on the privatization of small enterprises was passed, and in 1992 amended to increase the scope of small privatization program by eliminating the size restriction on entities that could be sold.

Whereas small privatization gained its momentum since 1992, progress on other aspects of privatization continues to be slow mainly because of a lack of clear policy on citizenship and the restitution of property to previous owners. The government has been unable to design a comprehensive approach to privatization methods and key issues such as restitution mechanisms and questions of citizenship have not been resolved. Furthermore, the institutional arrangements for privatization have also been in a state of flux. The existence of numerous governmental organizations has caused confusion about basic questions such as who is authorized to carry out privatization, what forms of privatization are permitted, and how information is reported and collected.

B.6.2. *Foreign Investment.* The foreign investment in Latvia is governed by its Law on Foreign Investment (November 1991), which provides the usual protection to foreign investors and offers tax incentives to attract foreign capital. Specifically, it provides full tax relief for three years

and partial tax relief for an additional five years, depending on the amount and share of foreign ownership. Furthermore, bankruptcy and antimonopoly laws are in place (December 1991) and at present more work is in progress to improve their implementation (OECD, 1994).

B.7. Lithuania.

B.7.1. Privatization. From the very beginning of Lithuania's economic reforms after independence in early 1990, systematic reform of the enterprise sector and in particular rapid privatization of the vast majority of state enterprises, has been an integral part of the government's policy to transform the Lithuanian economy into a market-oriented one. Legislation on privatization was passed in February 1991 and the privatization program is generally well developed and proceeding rapidly with the target of eventually privatizing two thirds of state owned property. Early on, the government introduced an innovative scheme that issued vouchers to all Lithuanian citizens. These vouchers, along with a quota of additional cash, could be used to purchase housing, a part of or entire enterprises sold through auctions, or shares in larger state owned enterprises.

To improve the management of state enterprises that are not scheduled for privatization in the immediate future, the government has made a considerable effort to create independent commercially oriented entities from previously state owned conglomerates and large enterprises. By early 1992, such enterprises were made independent of their funding ministries and given financial autonomy. Efforts have been made on a case by case basis to break up some large monopolistic state enterprises. As a result competitive pressures on enterprises are substantially increased.

B.7.2. Competition. A Competition Law, defining unfair competition and monopoly practices and identifying penalties for this behavior, has been passed. A Competition Agency and policymaking Competition Council has taken a number of measures to promote new private sector activities, such as passing a law providing tax concessions to small enterprises and financial institutions that lend to them. While the measures are a good beginning, strengthening competition will remain a crucial challenge over the medium term.

B.7.3. Foreign Investment. Lithuanian law permits three forms of foreign investment: joint ventures, in which a foreign shareholder owns part of a Lithuanian registered joint stock company; a Lithuanian enterprise totally established with foreign capital; and a Lithuanian subsidiary of a

foreign company. In addition, the foreign investment law provides the standard elements of protection to foreign investors and offers tax incentives to attract foreign capital. The law's original tax relief provisions were modified by a recent parliamentary resolution. Under the new provisions joint ventures and enterprises with foreign capital founded before the end of 1993 will receive a 70 percent profit tax relief for the first five years and a 50 percent tax relief for the next six years. Repatriation of profits and dividends received on foreign investment in Lithuania are not subject to tax. According to a new resolution by Parliament, in September 1992, state owned enterprises can issue shares in hard currency and foreign investors can invest in these enterprises by buying such hard currency shares (OECD, 1994).

B.8. Estonia.

B.8.1. Privatization. Estonia's privatization program has developed over time in a piecemeal fashion. It appears that its design is near completion. The last important components, involving the privatization of housing and medium and large enterprises, are not yet in place. However, since independence there has been considerable progress. A restitution process was launched as the initial form of privatization. The submission date for all domestic claims was originally set for January 17, 1992, for Estonian residents, but has been extended indefinitely for nonresidents. The government expected to identify all claims by early 1993.

Furthermore, legislation on the privatization of small enterprises was passed in December 1990, a pilot program to sell seven larger enterprises was introduced in 1991, and finally a housing reform law was approved in August 1992. However, there exist numerous obstacles to develop a coherent privatization program in Estonia. In particular, the lack of political consensus on key issues like the free distribution of some state property, hesitation to sell property for local currency while Estonia was still under the ruble zone, indecision about what concessions will be granted to employees during privatization, local government authorities impending potential privatization, ambivalence about private and foreign ownership and finally limits on the scale of land ownership for five years.

B.8.2. Foreign Investment. The Foreign Investment Law provides the normal elements of protection to foreign investors and offers tax incentives to attract foreign capital. Less promisingly, it contains several licensing procedures, special regulatory requirements and tax concessions which make it less desirable than other transforming socialist economies to potential investors. (OECD, 1994)

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